SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1966

No. 127

FEDERAL POWER COMMISSION, PETITIONER,

vs.

UNITED GAS PIPE LINE CO., ET AL.

No. 128

MEMPHIS LIGHT, GAS AND WATER DIVISION, PETITIONER,

vs.

UNITED GAS PIPE LINE CO., ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

INDEX

	Original	Print
Proceedings in the United States Court of Appeals for the Fifth Circuit	56	56
Order denying petitioner's application for stay	56	56
Motion of petitioner in Case Nos. 21872 and 21958 for leave and permission to withdraw and abandon certain issues	57	57
Motion of Texas Eastern Transmission Corporation in Case No. 22041 to withdraw appeal except as to particular issues, to sever retention of refund issue and to postpone proceedings as to severed issue	63	60

	Original	Print
Motion of Natural Gas Pipeline Company of America in Case No. 22031 to withdraw appeal except as to particular issues, to sever retention of refund issue and to postpone proceedings as to severed issue	72	64
Order granting motions	78	68
Opinion, Per Curiam	81	70
Judgment	85	73
Clerk's certificate (omitted in printing)	87	
Orders allowing certiorari	88	75
Orders allowing certiorari	89	76

INDEX

Volume I

	Page In Joint Appendix	Page In Record
Testimony of H. B. Dorau, Witness for Petitioner	2	(205-281)
Testimony of E. L. Dunn, Witness for Petitioner	24	(480-508)
Rebuttal Testimony of E. L. Dunn, Witness for Petitioner	36	(510-533)
Cross-Examination of E. L. Dunn, Witness for Petitioner	56	(2808-3390)
Stipulation Between Commission Counsel and Petitioner's Counsel Re Taking Union's Oil Losses	120	(3468)
Testimony of Kenneth L. Smith, Witness for Memphis Light, Gas and Water Division	121	(3671-3676)

In The

United States Court of Appeals

For the Fifth Circuit

United Gas Pipe Line Company, *Petitioner,* v. Federal Power Commission, *Respondent,* City of Memphis and Memphis Light, Gas and Water Division, et al, *Intervenors.*	No. 21872
United Gas Pipe Line Company, *Petitioner,* v. Federal Power Commission, *Respondent,* City of Memphis and Memphis Light, Gas and Water Division, et al, *Intervenors.*	No. 21958

JOINT APPENDIX

Volume I

Transcript of Testimony

(Joint Appendix Pages 1 to 125;

Record Pages 205 to 3676)

Excerpts from testimony of H. B. Dorau, a witness for UGPL Co.

Direct Examination

Q. Has United had any significant change in the cost of its debt capital in the period since June 15, 1961?

A. There has been a small increase in the cost of United's debt capital. This resulted from the issuance of two 4½ percent notes, one for $10,000,000 and the other for $36,000,000. Both notes are for a period of three years, the first having been issued on January 22, 1962, and the second note having been issued March 13, 1962. Both notes are owned by United Gas Corporation, parent of United.

The cost of United's outstanding debt capital prior to the issuance and sale of these notes was 4.42 percent and thus was increased slightly to 4.44 percent. The details of the outstanding debt capital of United are furnished in Statement F(3) page 1 of 2.

Q. Has there been any significant change in the cost of debt capital to United Gas Corporation in the period since June 15, 1961?

A. The increase in cost of debt capital to United Gas Corporation has been

(End of Page 4)

greater than the increase in cost to United. For the period involved (June 14, 1961 to March 31, 1962) cost of debt capital to United Gas Corporation increased from 3.94 percent to 4.05 percent (Statement F, Exhibit 8 in Docket RP60-2, and Statement F of the current filing) and has increased slightly with the issuance and sale of $40,000,000

of bonds sold on June 6, 1962, at a cost of 4.5058 percent, exclusive of expenses estimated at $175,000. The two factors responsible for this increase in cost of debt capital to United Gas Corporation are: (1) the reduction through the operation of the sinking funds for the older outstanding low cost issues of bonds and debentures, and (2) the additional borrowing of $80,000,000 in the form of two bank loans of $40,000,000 each at an interest rate of 4½ percent. At June 30, 1961, United Gas Corporation's outstanding debt consisted of $387,703,000 of bonds and debentures having a weighted average cost of 3.94 percent. As of March 31, 1962, this had been reduced to $370,307,000 but during this period $80,000,000 was borrowed from banks. The net result is that as of March 31, 1962, United Gas Corporation's outstanding debt amounted to $450,307,000 with a weighted average cost of 4.05 percent.

207

Q. What has been the change in bond yields and interest rate from June 1961 to April and May 1962 for which information may be available?

A. Interest rates and bond yields have not changed much from June 1961 to recent dates. The following may be noted:

(1) The yield basis on which 3-month Treasury Bills sold increased from 2.359 percent in June 1961 to 2.735 percent in April 1962;

(2) Long-term government bond yields rose from 3.88 percent in June 1961

(End of Page 5)

to 3.89 percent in April 1962;

(3) Prime commercial paper rates rose from 2.91 percent in June 1961 to 3.20 percent in April 1962;

(4) The yield on Moody's industrial bonds declined from 4.54 percent in June 1961 to 4.42 percent in May 1962;

(5) Moody's public utility bonds series declined in yield from 4.52 percent in June 1961 to 4.50 percent in May 1962;

(6) The yield on Moody's rail series was unchanged at 4.83 percent.

Q. What significance do you attach to these changes?

A. The changes are mixed and so small as to have little or no significance for the purpose at hand.

Q. Would these changes in bond yields indicate the

possibility of some reduction, however small, in fair rate of return for United today as compared with the fair rate of return at or about June 30, 1961?

A. No, because the change was too small and for other reasons.

Q. Please explain.

A. There are two other reasons. (1) The Federal Power Commission's practice of determining the fair rate of return allowance applicable to debt capital has been to base such allowance upon imbedded or historical cost of debt capital for the particular company and not upon the current cost of such capital for the class of enterprise or even the particular company when available. (2) The actual cost of debt capital to both United and to its parent, United Gas Corporation, will continue to increase for the indefinite future because of the influence of the operation of sinking funds. These sinking fund requirements call for a relatively faster repayment of the older

(End of Page 6)

low cost capital so that the bonds and debenture which remain outstanding tend to increase in cost. Another influence at work is the fact that current borrowing costs exceed the weighted average of historical or imbedded costs. Therefore, unless the bond markets rise quite substantially and bond yields drop correspondingly and large financing is undertaken at

209

lower than historical cost, there is no possibility that the weighted average cost of debt capital for United or its parent, United Gas Corporation, will decline in the foreseeable future.

• • • • •

221

Q. Why did you select A and Baa grade bonds for this part of your analysis?

A. Because these are the quality ratings given to the bonds of the United Gas Corporation, A for the mortgage bonds

222

and Baa for the debentures.

(End of Page 17)

Q. What is the significance and meaning of Table 5?

A. The tabulation on Table 5 records the capital cost experienced by the natural gas transmission companies from 1951 through March 31, 1962, on first lien obligations rated A. The yield range is wide, from 2.83 percent yield to investors in 1951 to 4.62 percent on January 11, 1962.

(222)

The table also calls attention to the fact that yields to investors are not the same as cost to the company. Column 7 records the cost rate to maturity at net proceeds. The cost of financing yield differential for recent issues has been from .10 to .12 of one percent.

The tabulation also sets forth the pro-forma debt ratio and the amount by which the yield to investors on each issue was above or below the average yield on Moody's A rated bond yield index. The last two issues sold on a yield slightly below Moody's average but generally the yield at offering price was higher than the average for A rated utility bonds.

Q. Where is the financing experience of United set forth?

A. In Statement F(3), on page 1 of 2.

Q. And where for the parent company, United Gas Corporation?

A. On page 2 of Statement F(3).

223

Q. What do you find was the market experience of United Gas Corporation's most recent sales of bonds?

A. The most recent financing of United Gas Corporation was on June 6, 1962, when $40,000,000 first mortgage and collateral trust bonds due 1982 were sold to investors on a 4.45 percent yield basis.

On a previous trip to the market on November 1, 1960, involving a

(End of Page 18)

two-pronged financing, first mortgage bonds and sinking fund debentures, the following yield and cost bases were established:

(1) A-rated 5 percent first mortgage bonds due 1980, 4.88 percent yield to maturity at offering price and 4.98 percent cost at net proceeds to the issuing corporation;

(2) Baa rated 5⅛ percent sinking fund debentures due 1980, 5.05 percent yield to maturity at offering price and 5.15 percent cost at net proceeds to the issuing corporation.

In both cases the cost-yield differential which represents the cost of financing was .10.

If the 1960 experience is applied to the present June 1960 financing, the following cost to United Gas Corporation can be derived as follows:

(1) For first mortgage bonds 4.45 percent yield basis which after cost of financing of .10 becomes 4.55 percent cost to the issuer,

(2) For sinking fund debentures by trending 1960 experience to present first mortgage financing 4.60 percent yield basis $(\frac{5.05}{4.88} \times 4.45)$ which after cost of financing of .10 becomes 4.70 percent cost to the issuer.

Giving effect to the present June 1962 financing on a pro-forma basis with respect to the proportion of first mortgage bonds and sinking fund debentures as total debt component, the result would be 68.5 percent of senior and 31.5 percent of junior debt.

Applying these weights to the cost basis established in (1) and (2), respectively, a weighted cost of 4.60 percent is derived [(4.55 x 68.5) ÷ (4.70 x 31.5)].

(End of Page 19)

Q. How does the historical weighted average cost of debt capital for United Gas Corporation compare with that of United?

A. The average dollar past cost for United was 4.44 percent and for United Gas Corporation was 4.05 percent.

Q. How does the price paid by United to United Gas Corporation compare with the price United Gas Corporation has most recently paid for debt money?

A. United is paying 4.50 percent on notes and United Gas Corporation is paying 4.50 percent on bank loans.

Q. What are the market yields on selected outstanding first mortgage bonds of United Gas Corporation?

225

A. As of March 1962, 4.34 percent on the 3⅝ percent issue, 4.32 percent on the 4½ percent issue and 4.60 percent on the 5 percent series of 1980. They average 4.42 percent.

Q. What was the market yield on the more recently issued sinking fund debentures of United Gas Corporation?

A. On the 4⅜ percent issue of 1972, 4.54 percent; on the 4⅝ percent issue of 1978, 4.48 percent; and on the

5⅛ percent issue of 1980, 4.80 percent. The three average 4.61 percent yield in March 1962.

The average yield on the six outstanding selected bonds of United Gas Corporation at the average March 1962 prices is 4.51 percent.

Q. What do you conclude as to the available cost evidence?

A. There is a difference between the historical cost of 4.05 percent to United Gas Corporation of debt capital employed and the current weighted cost of debt capital of 4.60 percent as derived from the recent market experience in June 1962, or the current cost of 4.51 percent (before an allowance for the

(End of Page 20)

difference between yields on outstanding bonds at market prices and yields at offering prices for new issues and before cost of financing) as derived from average yields on outstanding selected first mortgage bonds and sinking fund debentures at

226

average March 1962 market prices.

• • • • •

232

• • • • •

Q. What information is set forth on Table 21?

233

A. Table 21 sets forth the sinking fund schedule for the First Mortgage and Collateral Trust Bonds and the Deben-

tures of United Gas Corporation. This schedule of the accruing liability to repay is of practical importance since United Gas Corporation is the vehicle for public financing for United. The future final maturities and sinking fund requirements are substantial as may be seen from the extreme righthand column and the column headed "Semi-annual," total by years for the First Mortgage and Collateral Trust Bonds. The total fund requirements by years on the basis of securities then outstanding are:

(End of Page 26)

1961	$15,673,000
1962	16,915,000
1963	18,221,000
1964	18,897,000
1965	19,599,000
1966	20,326,000
1967	48,952,000
1968	16,182,000
1969	16,846,000
1970	22,965,000
1971	29,987,000
1972	43,374,000
1973	16,538,000
1974	8,398,000
1975	14,384,000
1976	8,127,000
1977	17,306,000
1978	25,551,000
1979	3,137,000
1980	22,496,000

Q. Have you also calculated the actual average dollar maturity for United Gas Corporation's First Mortgage Bonds

234

and Sinking Fund Debentures?

A. Yes. The three 20-year First Mortgage Bonds listed below have the following average maturities:

3⅜% due 1971 — 14 years, 5 months,
4½% due 1977 — 15 years, 7 months,
5% due 1980 — 14 years, 10 months.

This is just about half the term of loan of a typical 30-year electric utility bond.

The three 20-year sinking fund debentures have an average dollar maturity as follows:

4⅜% due 1972 — 14 years, 5 months,
4⅝% due 1978 — 14 years, 5 months,
5⅛% due 1980 — 14 years, 10 months.

Q. What bearing do these facts have on the comparative cost of debt capital?

(End of Page 27)

A. Direct comparisons of the yields on utility and gas transmission company bonds should not be made to reflect cost of capital evidence. To make direct comparison proper it needs to be determined what a natural gas transmission company would have to pay on a thirty-year bond with no sinking fund or other acceleration of maturity. The answer probably is they couldn't get such capital at a price worth paying because of the reliance on a wasting asset industry.

The actually shorter maturities and the sinking fund

operation leads the market to tolerate higher debt ratios, at least initially until "worked down" for gas transmission companies than for electric utilities. If this higher spot debt ratio is used to weight the cost of debt capital, it will operate to prejudice the composite dollar cost of capital and thus the fair rate of return so far as it may be derived therefrom.

• • • • •

• • • • • •

Q. After having analyzed the evidences as to the cost of debt and the cost of equity capital, what yet needs to be done before determining an average dollar cost of capital?

A. It still needs to be determined what weights to give each class of capital cost in order to find a composite or average dollar cost.

Q. What facts have you gathered as a basis for this determination?

A. There have been set forth in Statement F and in the supplement to Statement F the debt and equity ratios for United Gas Corporation and United, as well as the capital proportions

for the 10 comparison transmission companies

(ends page 48)

(Table 18). They may be summarized for convenience as follows for 1961:

	Debt	Preferred	Common
10 Transmission companies..	59.0	9.9	31.1
United	55.5	—	44.5
United Gas Corporation	59.2	—	40.8

As of March 31, 1962, the ratios for United and United Gas Corporation were:

	Debt	Common
United	60.14	39.86
United Gas Corporation (Cons.) ..	60.69	39.31

Q. In summary, what evidences of the cost of debt capital will you use for alternative composite cost of capital calculations?

A. I will make alternative composite cost of capital determinations for:

United:

Imbedded average dollar cost	4.44%
Current cost of debt capital at a 60% ratio	4.85%

United Gas Corporation (Cons.):

Imbedded average dollar cost	4.05%
Current cost at a 60% debt ratio	4.60%

Q. What evidences of equity return ratios do you bring forward for alternative use in the determination of a composite cost of capital determination?

A. I would draw upon the exhibit, text and text tables for the following:

1. Ten natural gas pipe line companies:

a. 1971 earnings on common equity:

(1) average of ratios as reported on average equity	13.65%
(2) weighted average ratio, adjusted for refunds on beginning of year equity	13.59%
(3) average of ratios adjusted for refunds on average equity	13.65%

(ends page 49)

b. Average 1946-1961 earnings on common equity:

(1) average of ratios as reported on average equity	16.05%
(2) weighted average ratio, adjusted for refunds on beginning of year equity	16.62%
(3) average of ratios, adjusted for refunds on average equity	15.62%

c. Earnings-price ratios on common stock:

(1) average of current earnings to current prices 1946-1961	7.37%
(2) 7.37%, adjusted by average investor experience, 1946-1961	11.43%
(3) 7.37%, adjusted by weighted average investor experience, 1946-1961	13.46%
(4) 7.37%, adjusted by average discounted earnings-price ratios, 1946-1961	10.36%

(5) 7.37%, adjusted by weighted average investor experience, 1946-1961 ..... 10.94%

262

d. Equity investor experience on compound return basis:

(1) average of investor return experience, 1946-1961 ..... 12.5%

(2) weighted average investor return experience, 1946-1961 ..... 12.1%

(3) average of investor return experience, 1949-1954 ..... 11.8%

2. United Gas Pipe Line Company:

a. Average 1946-1961 earnings on common equity:

(1) average of ratios, income as reported on average equity 8.27%

(2) average of weighted ratios, income adjusted on beginning of year equity.... 7.27%

(3) average of ratios, income adjusted on average equity 7.60%

(ends page 50)

3. United Gas Corporation:

a. Equity investor experience on compound return basis:

(1) average of investor return experience, 1946-1961 ..... 9.5%

(2) weighted average investor return experience, 1946-1961 ..... 8.6%

4. Equity investor experience in other industries:

(1) 10 natural gas distributing companies, 1952-1961 ..... 16.3%

(2) 30 natural gas companies 1952-1961.... 12.5%

(3) Moody's 24 electric utilities 1952-61..... 14.2%

(4) 25 railroads, 1952-1961 ..... 8.3%

(5) 125 industrials, 1952-1961 ..... 14.4%

263

Q. Will you now indicate how the composite cost of capital is derived from the evidences developed?

A. A first determination may be made on the basis of the imbedded debt capital cost of 4.44% for United with a debt ratio of 60% as of March 31, 1962.

Using for this purpose the average of the four adjustments made to the average earnings-price ratios for the 10 comparison companies for the period 1946-1961 of 7.37% to reflect investor's actual experience as shown in l.c., (2), (3), (4) and (5) of 11.5% for an equity cost, will produce the following:

4.44% debt cost at 60%	equal	2.664%
11.5 % equity cost at 40%	equal	4.600
Average dollar cost		7.264%

Using a current debt capital cost of 4.6%, as derived from market valuations for the debt of United Gas Corporation, the result would be:

(ends page 51)

4.6% debt cost at 60%	equals	2.76%
11.5% equity cost at 40%	equals	4.60
Average dollar cost		7.36%

Using an estimated debt capital cost to United of 4.85%, the result on otherwise the same basis would be:

4.85% debt cost at 60%	equals	2.91%
11.5% equity cost at 40%	equals	4.60
Average dollar cost		7.51%

Using as a base the experienced equity earning rates for

the 10 comparison companies of 13.59% for 1961 and the capital structure ratios as of the end of 1961 of 31.1% equity for the 10 comparison companies and 44.5% for United, affords another test. To use the ratios for the 10 comparison companies, however, requires adjustment for the difference in equity ratios. Adapting the 13.59% equity rate to the 44.5% United Equity ratio in direct proportion to the difference in equity proportions, results in a 12.0% ratio applicable to United. Applied as above in

combination with an imbedded debt cost of 4.44% produces the following:

4.44% debt cost at 55.5%	equals	2.46%
12.00% equity cost at 44.5%	equals	5.34
Average dollars cost		7.80%

Substituting a current debt capital cost of 4.6% for the 4.44% past cost, produces the following result:

4.60% debt cost at 55.5%	equals	2.55%
12.00% equity cost at 44.5%	equals	5.34
Average dollar cost		7.89%

• • • • •

275

• • • • •

Q. What further evidence as to the relative investor appraisal of divisions of the gas industry have you provided on Schedule 2C?

A. On Schedule 2C, there is offered the evidence as to the rating given six gas companies identified in Staff Exhibit as "holding companies".

In fact, as is set forth in the schedule immediately following #3, five of these companies, i.e., excluding United Gas Corporation, are large gas distributing systems. Moody's classified five of this group as integrated companies. The dominance of the gas distributing function makes the inclusion of United Gas Corporation a strain on the homogeneity which should be the basis of classification and grouping. Five of the companies on Schedule 2C are in structure holding companies. The one which is an operating company as

well as owning the stocks of other corporations is United Gas Corporation. The corporate structural form is not of prime importance however. It is the dominant character of the operations and class of service rendered.

A tally of the rated bonds of the five systems dominated by local distribution service discloses that out of 79 issues, 25 are Aa, 41 are A, 12 are Baa, and 1 is Ba, clearly a very different quality level

(End Page 5)

than that found for pipe line companies, and incidentally 3 of the Baa rated bonds are those of a pipe line subsidiary.

Q. Will you now refer to Schedule 3 and explain what it sets forth?

A. Attention is first directed to the figures in Column 1 showing the proportion of gas revenue obtained from residential and commercial service. The integrated distribution companies obtain an average of 57% of their revenues from residential and commercial service while for United Gas Corporation this business accounts for only 12.8%. Sales for resale accounted for an average of only 15.1% of the revenue of these ten companies, while representing 35% of the revenue of United Gas Corporation, consolidated.

In Staff exhibit ...., United Gas Corporation is included with the first five of the ten companies set forth in Schedule #3 under the label "holding comapnies". Using then only the

first five companies in Schedule 3 it may be noted that the distribution of gas revenue only, since the group of 5 has substantially no non-gas revenue, is as follows:

	Percent — Distribution of Gas Revenue			
	All Gas Revenue	Residential Commercial	Industrial Sales Revenue	For Resale Revenue
Five companies	100.0	63.7	20.7	15.6
United Gas Corp. (Cons.)	100.0	15.1	43.7	41.2

In contrast the 10 natural gas pipe line companies (based on 9, 1 unavailable) identified on Schedule 3 and used in Staff Exhibit .... reflected an entirely different distribution of gas revenues by reference to either the five distribution systems previously noted or United Gas Corporation (Cons.).

(End Page 6)

	All Gas Revenue	Residential Commercial	Industrial Revenue	For Resale Revenue
Pipe Line Cos.	100.0	4.1	12.1	83.8
United Gas Corp. (Cons.)	100.0	15.1	43.7	41.2

Q. What conclusion do you draw in general from the analysis of Schedule 3?

A. Five out of the six companies identified as holding companies in Staff Exhibit ...., page 43, are in fact predominantly distribution systems and not similar in character of business to United Gas Corporation (Cons.). These five distribution systems are again very different in character of

278

business from the natural gas pipe lines identified in the lower part of Schedule 3. It is United Gas Pipe Line Company that could be properly identified with the pipe line companies and in this comparison important differences are to be noted as set forth in company (Dorau) testimony, pages 35-38. Distributing gas utilities are clearly to be distinguished from natural gas pipe line companies and natural gas producers. United Gas Corporation operates in only a relatively small way as a gas distributing utility. Its natural gas production is through a separately organized and operated subsidiary as is its natural gas transportation business.

• • • • •

281

Q. What further evidence as to the level of earnings achieved and available in industries of equal or less risk than that characterizing the natural gas pipe line enterprises is provided in Schedule 4B?

A. Schedule 4B reflects the results experienced by the common stock investment in 10 natural gas transmission companies from 1952-1961.

The market price increased from $33.88 in 1952 to $64.28 in 1961, an increase of $30.40, or 89.73%. Dividends per share increased from

(End Page 9)

$1.45 to $2.83, an increase of $1.38, or 95.2% in 10 years.

In the lower half of tabulation on Schedule 4B there is set forth the return rate earned on common equity for the

(281)

Moody selected 10 gas distribution companies for the years 1956-1961. The range is from 11.7% to 12.4% on an aggregate (weighted by size) basis and from 12.3% to 13.1% on an average of rates of return earned. As a division of the gas industry this level of earnings affords a basement level from which the necessary return rate for the more hazardous pipe line division of the industry may be developed. A level above 12% for the extra hazard of pipe line investments is indicated and this leaves no margin as such for absorbing the extra-extra levels of risk and uncertainty reflected by any associated natural gas production.

282

It may further be noted by reference to the table in the lower half of Schedule 4B that the market price of the gas distributing company common equity has increased from $28.41 in 1956 to $59.36 in 1961, an increase of $30.95 or a 108.9% increase in 5 years. The dividend rate increased from $1.43 to $1.91, or 33.6%.

• • • • •

283

• • • • •

Q. What general conclusion do you draw from these evidences of investor experience with earnings, dividend and market price increase?

A. That earnings-price ratios afford no measure of investor return expectation or achieved return rates during a bull market and probably never except by chance.

(End Page 11)

Q. What is the purpose of Schedule 5?

A. Schedule 5 sets forth, comparatively, the results

in terms of percent return available on the common equity at a predetermined 6.5% rate of return of the use of various debt capital cost rates and two alternative debt ratios.

Thus, at a 60.39-39.31 capital structure an inbedded debt cost rate of 4.5% will leave as a balance 10.28% on equity. This is as reflected in Staff Supplemental Exhibit ....., at page 1. I understand that this imbedded cost of debt capital is for United Gas Corporation but presumably to apply to United Gas Pipe Line Company.

In order to test the effect of the arbitrary selection of debt cost rates I substituted the several obvious alternatives even though I am quite aware of the baekwards character of the procedure and that apparently there is no direct determination of a return ratio for common stock capital.

If in the first instance the imbedded 4.44% cost of United Gas Pipe Line Company were used to find a return rate for United Gas Pipe Line, the balance for common stock would be 9.60% and not 10.28%.

If the current cost of debt capital found by reference to the market appraisal of United Gas Corporation securities of 4.60% were used the rate for the common stock equity by the residue method would fall to 9.35%.

If the current cost of debt capital found for United Gas Pipe Line Company of 4.85% were used, the rate resulting

(281)

285

for the common stock equity by the residue method would fall further to 8.98%.

(End Page 12)

Similarly, as set forth in the upper section of Schedule 5, if the December 31, 1961 capital structure ratios were used the results would be 9.17%, 8.97% and 8.67% under the same alternative 4.44%, 4.60% and 4.85% debt capital cost applications, as compared with the 10.28% presented in Staff Supplemental Exhibit, page 1.

• • • • •

480

Excerpts from testimony of E. L. Dunn a witness for UGPL Co.

Direct Examination

Q. Will you please proceed as to the additional schedules?

A. Yes. Before explaining the content of Schedule H(3)-3-(a) I should point out that United Gas Pipe Line Company (United) is included in a consolidated federal income tax return as the wholly-owned subsidiary of its parent corporation, United Gas Corporation (Gas Corporation). Union Producing Company (Union) is also included in the same consolidated return as a wholly-owned subsidiary of its parent corporation, Gas Corporation. A number of other so-called name-saving companies are also included in the consolidated return, but these companies contribute no income or loss to the consolidated income. Specifically Schedule H(3)-3-(a) shows for the taxable year 1960, the most recent year for which a return has been filed, the computation of consolidated net taxable income for the three corporations to which I have referred as well as the

computation of the consolidated system tax liability. Also shown at the foot of the schedule are the details of the consolidating adjustments.

(End of Page 6)

Q. Do you have any further comments in respect of Schedule H(3)-3-(a)?

A. Yes, but I would prefer to reserve these comments for a later point in my testimony where I intend to discuss

• • • • •

485

Q. Will you please state as to what particular point your comments will be directed?

A. Yes. The comments which I am about to make relate to the matter of determination of the federal income tax expense includible in cost of service of United for the test period.

Q. Will you please proceed?

A. As indicated by Schedule H(3)-a, the amount of federal income taxes included in cost of service for the text year has been computed on United's net taxable income for the year at the statutory rate of 52%. As to the propriety of the use of the 52% rate I should like, at the outset,

486

to make a general observation. It is recognized rate procedure that in the determination of cost of service for the purpose of establishing appropriate rates only the revenues and deductions of the company the rates of which are under

consideration be used and that non-current, non-recurring, out-of-period, and non-utility items of a substantial nature must be eliminated in the determination of such cost. Consistency demands that the federal income tax allowance includible in and made a part of such cost of service be determined on the same basis. The amount of federal income tax results from two things: (1) a properly determined amount of taxable income to which the tax rate is to be applied, and (2) the tax rate itself. In the determination of taxable income the same procedure as I have

(End of Page 11)

just outlined for cost of service is followed. To apply to such taxable income a rate of tax developed by application of the so-called consolidated return tax savings theory would be inconsistent with the rate making principle otherwise followed.

Q. In what way would the use of such a tax rate be inconsistent?

A. To understand this one must understand that the period of time during which revenues and deductions may be used in determining taxable income in a federal income tax

return is controlled by provisions of the Internal Revenue Code. Quite often the timing for tax purposes does not coincide with the timing for book accounting nor with rate making requirements. An example of this is explained later in my testimony in respect of federal income tax for 1961. Further, the Revenue Code often requires the inclusion in or exclusion from taxable income of items of revenue or deductions which must be treated differently for book accounting and rate making purposes. Finally, in a consoli-

dated tax return the revenues and deductions of several companies are combined into a single amount of net taxable income. Therefore, the use for rate making purposes of a tax rate developed by application of the so-called consolidated tax return savings theory would apply a tax rate in determination of federal income tax included in cost of service that is affected by items included in the consolidated tax return which are unrelated to and have no bearing on the regulated gas business. Some examples of such items are:

(End of Page 12.)

(1) Inter-company transactions between non-utility members of the group filing a consolidated return not affecting in any way the regulated company nor the consolidated tax allocated to and paid by such company.

(2) Capital gains and losses which have nothing whatsoever to do with the regulated gas business.

(3) Non-operating, non-recurring, non-jurisdictional, and out-of-period expenses, losses, or gains and income not taken into account in establishing cost of service and return included therein, and

(4) Income and deductions of other companies.

These items on the one hand are properly includible in the consolidated tax return in order to comply with the provisions of the Internal Revenue Code and in some cases they produce a loss for a given company in the consolidated group which superficially at least seems to produce a so-called tax saving to other companies contributing income to the consolidated group taxable income. But where these items are disregarded in the rate making

(488)

procedure, if they are not disregarded for all purposes of such procedure including the proper tax rate to be applied in the computation of federal tax expense includible in cost of service, an inconsistent, distorted result follows which is not compatible with proper regulatory procedure consistently applied.

• • • • •

490

And, second, is the fact that in the computation of the consolidated tax the so-called 2% tax penalty provided by law for the filing of a consolidated return must be applied to Union's taxable income included as part of the consolidated taxable net income for 1962 since Union is not a regulated public utility within the meaning of the tax law. United, of course, is a regulated company under the tax statute and for this reason the 2% consolidated return tax penalty does not apply to its taxable income.

• • • • •

499

• • • • •

The third reason is that it is also a fact that under the tax law any Union net loss which is a part of the consolidated taxable income in the return filed by the United

(End of Page 22)

Gas group and which loss is not utilizable to Union as a carry-over or carry-back on a separate return basis must be applied in reduction of the tax cost basis of Gas Corporation's investment in the securities of Union. Union has sustained losses of this character which are substantial in aggregate amount but as to which I have made no precise computation. The significance of this effect of the tax law is in the

500

fact that such effect gives rise to, as to Gas Corporation, a potential tax liability in some future year should Gas Corporation dispose of its investment in Union either by outright disposition to third parties or by the process of the retirement of Union's indebtedness as between Gas Corporation and Union; or alternatively, when Gas Corporation receives from Union dividends which for tax purposes are deemed as distributions not out of Union's earnings and profits and as such are applied in reduction of the tax cost to Gas Corporation of Union's stock investment.

Q. Will you please amplify the latter part of your answer respecting the tax effect of certain dividends paid by Union to Gas Corporation?

A. As I stated in my last previous answer, not only do losses of Union non-utilizable as carry-backs or carry-overs operate to reduce the tax cost basis of Gas Corporation's investment in the securities of Union but the same effect occurs also as to any dividends Union pays which for tax purposes are considered as distributions not out of Union's earnings and profits. As I have stated, the combination of these two

(End of Page 23)

factors operates to reduce Gas Corporation's tax cost basis of its investment in the stock of Union. When that basis reaches zero any further Union dividend distributions of

this character must be included in taxable income of Gas Corporation as capital gains. Dividends aggregating $25,632,970 for the four-year period, 1957 to 1960, inclusive, have been paid by Union to Gas Corporation which for tax purposes are distributions which must be applied to reduce the tax cost basis of Union's stock in the hands of Gas Corporation. Thus, under operation of the tax law and regulations these Union deficits in taxable income do in literal, ultimate effect increase taxable income either to Gas Corporation or to Union.

Q. You have testified that under specified circumstances the application of Union's net losses in reduction of Gas Corporation's investment in the securities of Union could ultimately bring about taxable income to Union. Can you amplify this point?

A. Yes. As I have stated, under appropriate circumstances which I have described, Union's losses as well as certain dividend distributions by Union to Gas Corporation must for tax purposes be applied by Gas Corporation to reduce the tax cost of Union's stock in the hands of Gas Corporation. When that basis reaches zero any further Union losses are applied under the tax rules to reduction of the tax cost of Gas Corporation's investment in the debt securities of Union. Thereupon when Union retires such indebtedness, under

(End of Page 24)

consolidated return rules, the difference between the reduced tax cost basis of the debt to Gas Corporation and its principal amount would be taxable income to Union and before part of consolidated taxable income in the year of such debt retirement.

Q. How do the tax results to which you have testified bear upon the question of the effect of the inclusion of Union's loss in the filing of a consolidated tax return?

A. All that which I have here pointed out should be considered against the background of this significant fact, to wit: Gas Corporation's investment in stock and debt of Union, together with Union's internally generated cash necessarily have financed the Union deficits in taxable income here discussed. This follows because Union's stock and debt securities are held entirely by Gas Corporation. United's customers did not supply the money used for the expenditures which gave rise to these deficits in Union's taxable income. Likewise none of Union's investment in plant and property is included in United's rate base. Neither are any of Union's expenses included in United's cost of service in this proceeding.

But an application of the so-called consolidated return tax savings to United would give that company's customers the benefit thereof although none of the money required to finance Union's operations was supplied by United's customers nor did they take any risks inherent in such operations

nor were they charged for any part of Union's operating expenses or a return on its investment in plant.

(End of page 25)

Hence, as I have said at the outset, the result described further supports a determination of United's cost of service federal income tax expense at the rate of 52 per cent without regard to any of the tax effects which may arise from the inclusion of Union or any other loss company in a consolidated tax return which also includes United.

• • • • •

• • • • •

Q. Earlier in your testimony in respect of Schedules H(3)-3-(b) and (c) you develop the point that because of Union's loss carry-overs Union will not be called upon to pay any part of the consolidated tax for the years 1961 and 1962 even though in such years Union contributes taxable income to the consolidated taxable net income. Isn't that correct?

A. That is correct.

Q. You have also testified that the 1961 and 1962 allocation of the consolidated tax results in assignment of all of the consolidated tax to United with a consequent tax payment by United in an amount in excess of the statutory

rate applied to United's taxable income. Isn't that true?

A. Yes, that is true, if for the year 1961 due adjustment is made in computing the consolidated taxable income so that there is recognition of non-recurring, non-utility and out-of-period items as to which I have testified in some detail.

Q. Does this mean then that United in effect in 1961 and 1962 would be paying for a part of the benefit of the earlier year net losses of Union?

A. Generally speaking, that is true.

Q. Why does this result follow in light of your earlier testimony that it is Gas Corporation which in ultimate effect will have to bear the later tax burdens which arise out of the earlier

(End of page 27)

tax benefits brought about by the utilization of Union's losses in a consolidated return? As I understood your testimony it is United which in 1961 and 1962 at least is bearing the burden.

A. Your understanding is correct. Gas Corporation, in the allocation of the consolidated tax for the years during which Union contributes a loss is not assigned the full benefit of that loss since a portion of it is assigned to United through the procedure of allocation of the consolidated tax to United as well as a portion to Gas Corporation where both companies contribute a taxable income to the consolidated net

taxable income. Although we recognize the result I have described and are aware that some other allocation could be used for book accounting purposes, we felt it is better to allocate the consolidated tax in accordance with the rules prescribed by the tax law in the computation of earnings and profits of the respective companies which are included in the consolidated return. This method of consolidated tax allocation for income tax earnings and profits is authorized by Section 1552(a)(1) of the Internal Revenue Code and the use of this method enables us to establish the earnings and profits of the respective companies. These tax earnings and profits, as I have previously testified, are determinative of the tax status of inter-company dividends paid by the subsidiary companies to the parent company. But I know of nothing in these tax law provisions which has even a remote bearing on the tax calculation procedures necessary in establishing

(End of page 28)

federal income tax cost of a regulated company to be included in its cost of service where such company files its tax return as part of a consolidated group and its income in the computation of the consolidated tax is co-mingled with the income of other companies, certain of which have non-utility, non-regulated income and losses unrelated to the regulated company.

507

Q. In the light of your testimony, would you say that the allocation of consolidated tax has any bearing upon the proper determination of allowable federal income tax of a regulated company for cost of service purposes?

A. No.

Q. Will you state your reasons for your answer?

A. Yes. It has seemed to us that it is not necessary to make cash payments representing adjustment of tax as between one company and another in the consolidated group. This result holds even though certain effects arise as to carry-over or carry-back of net losses from one year to another. The reason is that in ultimate result it is the parent company's investment in the subsidiary companies through its equity interest in such subsidiaries which bears the cost of utilization of the losses in the consolidated return as I have previously testified, and there is no need to engage in a series of inter-company cash transactions where the overall and ultimate effect inures in any event to the parent company stockholders, as it should. The procedure which I have described in allocation of consolidated tax under the

(End of page 29)

inter-corporate capital structure of the United Gas group simply cuts through the distortions and imbalances inevitably associated with assignment of the consolidated tax under an

inflexible and unchanging method. Further it recognizes that if so-called savings under the allocation method employed do go in one direction and associated tax burdens in another all these effects merely influence equity, and equity alone, and thus the tax burdens and the tax benefits converge to the parent company and its stockholders. The conclusion is that all the burdens and benefits refer-

(508)

able to the regulated company's operations should be and are taken into account in the 52 per cent rate computation for rate making purposes, and all other tax burdens and benefits of the consolidated group not related to the regulated company pass to the stockholders to whom they belong.

• • • • •

510

Excerpts from Rebuttal Testimony of E. L. Dunn, a witness for United Gas Pipe Line Co.

Q. Are you the same W. G. Meece who testified on direct examination in this proceeding?

A. Yes, I am.

Q. I show you an exhibit titled "United Gas Pipe Line Company Summary of Taxable Income — Years 1957 to 1961, Inclusive, Restated to Reflect Certain Adjustments as Indicated by Detailed Schedules." Was this Exhibit No. 14-1, for identification, prepared by you or under your direction?

A. Yes, it was.

Q. Will you explain this exhibit?

A. This exhibit contains data pertaining to the Consolidated Federal Income tax returns of United Gas Corporation and subsidiaries for the years 1957, 1958, 1959, 1960 and 1961. The purpose and results shown by the various schedules will be discussed later in my testimony.

Q. In your direct testimony in this proceeding, Mr. Meece, you stated that the amount of federal income taxes included in cost of service as determined by United Gas Pipe Line Company (United) for the test year has been computed on United's net taxable income for the year at the statutory rate of 52 percent. Is this correct?

A. Yes.

Q. Have you read the testimony of Staff witnesses

511

Warner and Brinn and the testimony of Memphis witnesses Smith and Rowe as presented in this proceeding?

A. Yes.

Q. Have you examined Exhibits 19-1 and 19-2, which Staff Witness Warner sponsored and Exhibit 23, which Memphis Witness Smith sponsored?

A. Yes.

Q. As to the tax rate do the testimony and exhibits of the Staff and Memphis to which I have just referred state a conclusion in accord with the statements you have made in your direct testimony?

A. No.

Q. Will you summarize in what respects the Staff and Memphis witnesses differ with you on the point of the tax rate to be applied?

A. The Staff and Memphis testimony and exhibits to which you refer, in general, apply the so-called effective rate procedure in the determination of federal income tax expense includible in cost of service.

Q. Will you describe briefly the technique employed by these witnesses in applying the effective rate method in ascertainment of federal income tax expense?

A. Yes. United is included in a consolidated federal income tax return filed by United's parent, United Gas Corporation (Gas Corporation), in which return also are

512

included Gas Corporation's

(End of Page 2)

wholly-owned subsidiaries, Union Producing Company and United Overseas Production Corporation. When one or

(512)

more of the corporations included in a consolidated income tax return report a net loss for tax purposes, such loss operates to reduce consolidated taxable income with corresponding effect upon the consolidated tax. The effective rate derives from assigning to the separate companies included in the consolidated return which show taxable income a part of the so-called saving which arises as a result of the deduction from consolidated taxable income of the loss or losses shown by other affiliates.

Q. Will you explain in somewhat greater detail the method employed by the Staff and Memphis witnesses in determining the effective rate which they claim should be applied for the purpose of calculating the federal income tax expense component?

A. An effective rate determination was made, following generally the method which I have previously described, for each of five years prior to 1962, using for this purpose the amounts of taxable income derived from the consolidated tax returns filed by Gas Corporation and its affiliates, of which United is one. The effective rate determination to which Staff Witness Warner has testified is shown by Schedule No. 5

513

of Exhibit 19-1 presented by him in support of his testimony. The effective rate determination made by the Memphis Witness Smith is shown by Schedule No. 6 of Exhibit 23 filed by that witness in support

(End of Page 3)

of his testimony. In the Warner exhibit a five-year average from 1956 through 1960 is used while in the Smith exhibit a five-year average from 1957 through 1961 is employed. The

Warner exhibit thus develops a five-year average effective tax rate of 49.81 percent. The Smith exhibit shows two figures as an average effective rate — one which is an average determined by totalling the taxable income of United alone for the five-year period used by Smith and dividing such aggregate taxable income by the aggregate amount of allocated tax for the same period which produces a so-called effective rate of 48.537 percent and the Smith exhibit also shows an arithmetical average of the effective rates for the five years of 48.001 percent. In utilizing the effective rate for the purposes of his testimony Mr. Smith has employed the effective rate of 48.537 percent. Staff Witness Warner, while reaching an effective rate figure of 49.81 percent, has utilized an effective rate figure of 49.69 percent for other computations in his testimony. There is no apparent explanation for this slight difference in rate used by the staff witness.

Q. Do you consider that the so-called effective rate

method of determining the federal income tax component for United is correct?

A. No. I have referred to the matter of the use of an effective rate for the purposes of this proceeding in my direct testimony and I have testified that it does not produce a correct result. The reasons for my conclusion have been stated at some length in my direct testimony.

(End of Page 4)

Q. You have testified that the effective rate theory arises solely because of the filing of a consolidated income tax

return in which United has been included as a subsidiary. Is this correct?

A. Yes.

Q. Will you state the various companies which have been included in the consolidated return for the years referred to in the Warner and Smith exhibits and in general give a description of their operations?

A. During each of the years referred to in the Warner and Smith exhibits the consolidated federal income tax return filed by United Gas Corporation included United Gas Corporation, United Gas Pipe Line Company, and Union Producing Company (Union), and certain so-called name saving companies which have no income or expense and are not germane to this discussion. Beginning with the year 1961 the consolidated return has also included United Gas Corporation's wholly owned

subsidiary United Overseas Production Corporation (Overseas). Gas Corporation is the parent company of the group; it owns all of the capital stock and all of the outstanding long-term indebtedness of each of the subsidiary companies. Gas Corporation also owns and operates natural gas distribution systems in various areas of Texas, Louisiana, and Mississippi. The income of Gas Corporation from which arises the taxable income reported by that company in the consolidated return is derived from its distribution operations plus the interest and dividends which it receives from its subsidiaries, and also

(End of Page 5)

dividends and interest which it receives from investments in other companies not included or includible in the consolidated return. United's taxable income is derived from the operation of its pipe lines and gasoline extraction plants and certain minor miscellaneous income. The income it receives from these operations is reduced by the expense incurred in conducting such operations and by the interest which it pays on its indebtedness to its parent company, in determination of taxable income included in the consolidated return. Union is engaged in the business of the exploration, development, and operation of both natural gas and oil properties. Its revenues are derived from the sale of natural gas and oil as produced. Only a part of the natural gas produced by Union

is sold to United. Union's taxable income is determined by deducting from the gross revenues it receives from the sale of oil and gas, its expenses of operation as well as certain other deductions permitted for tax purposes in the computation of Union's taxable income. In general the latter category includes deductions for intangible drilling expense, percentage depletion, depreciation as ascertained for tax purposes and like items. Beginning with the year 1961 Overseas, a newly organized wholly-owned subsidiary of Gas Corporation, was included in the consolidated return. The operations of this company are conducted entirely outside the United States and at the present time consist of participation in an oil exploration project in Tunisia, North Africa. For the year

(End of Page 6)

1961 it reported a net loss for tax purposes. Consolidated taxable income for the group is the sum of the taxable income figures of each company in the group less elimination of intercompany dividends and certain other minor intercompany adjustments.

Q. To what extent are the rates of Gas Corporation and its subsidiaries participating in the consolidated return regulated by any State or federal commission?

A. With respect to Gas Corporation in its distribution operations, its rates are subject to regulation in Mississippi by the Mississippi Public Service Commission, in Louisiana

by the Louisiana Public Service Commission, and in Texas by the municipalities it serves and the Texas Railroad Commission.

With respect to United, its rates are regulated by the Federal Power Commission insofar as they concern sales made under tariffs filed with that Commission. In addition, certain sales by United for resale at town borders in Louisiana are regulated by the Louisiana Public Service Commission and certain similar sales in Texas are subject to regulation by the Texas Railroad Commission. Direct sales by United to industrial customers are generally not regulated.

With respect to Union, rates for sales of natural gas pursuant to contracts filed with the Commission are subject to its regulation. Union's sales of oil and other related products are not regulated.

(End of Page 7)

There is, of course, no regulation involved in certain activities of the parent company, Gas Corporation, such as the sale of merchandise and performance of appliance repair services, research and sale in respect of various types of instruments useful generally in the natural gas industry, and the receipt of interest and dividends on investments.

Q. Reverting to the matter of the determination of an effective rate as shown by the exhibits filed by Messrs. Warner and Smith, and assuming only for the purpose of this

518

question that (a) the effective rate method is an acceptable technique for the purpose intended, and (b) the five-year average technique is an appropriate one for the purpose intended, do you have any comment in respect of the application of the method itself as developed in the Warner and Smith exhibits?

A. Yes.

Q. Will you please state such comments?

A. I should like to make the following points which apply directly to the computations used in Warner Exhibit 19-1 and Smith Exhibit 23. My first point relates to the figures of taxable income shown for each year which were those derived, in the case of the years 1958 through 1961, from the consolidated returns filed for the respective years. These returns are subject to the usual routine examination by the Internal Revenue Service and as to certain years revenue agent audit adjustments have been made which change the figures of taxable income. Further adjustments have been made by the Internal

(End of Page 8)

Revenue Service in respect of the years 1956 and 1957, which are not reflected in the Staff and Memphis exhibits. For the intended purpose and subject to the assumptions you have stated, I would say that the figures as shown by the revenue agents' reports for the various companies as to the years in

519

respect of which Internal Revenue Service examinations have been completed should be used since these supersede the tax return figures. As to the years here concerned, the consolidated tax returns have been examined for each of the years 1956 through 1959, inclusive.

Q. Does your exhibit show the figures you consider to be correct for the purpose and under the assumptions previously stated?

A. Yes.

Q. Do you have other comments to make in respect of the subject under consideration?

A. Yes. The second point is that the consolidated taxable income figures in any event should not include the result of Union's oil operations.

Q. Will you state your reasons for your response to the last previous question?

A. The oil operations of Union are wholly outside of the jurisdiction of the Federal Power Commission. Union's oil operations do not have even a remote bearing upon the determination of proper rates for the sale of gas within the jurisdictional authority of any regulatory commission. No part of the cost of such oil operations by Union is chargeable to United's customers, and in no way do these

(End of Page 9)

operations affect the costs chargeable to United's customers.

Union's oil operations are non-regulated and unrelated to the activities of United. It appears entirely appropriate, therefore, that even if the effective rate technique were applied in this case, it should be applied in such manner so that taxable income figures in any case would not include any taxable income or loss figures arising from Union's oil operations. My Exhibit 14-1 shows for each of the years 1957 to 1961, inclusive, the taxable income or tax loss result in respect of the oil operations of Union as distinguished from such income or loss arising from Union's gas operations. The amounts of such taxable income or net loss for tax purposes in respect of Union's oil operations is shown in the Schedules 8 to 12.

Q. Do you have further comments?

A. The figures of taxable income used in the Warner and Smith exhibits should also be adjusted in respect of the following items:

(a) The taxable income of Gas Corporation should be restated for each year affected by the 1961 rate refund which Gas Corporation was called upon to make as result of the decision of the Mississippi Public Service Commission, and the taxable income of Gas Corporation and United should be restated for each year affected by the 1962 rate refunds directed by the Federal Power Commission and agreed upon by United in Docket No. G-9547, et al.

(b) The taxable income of United should be increased for the year 1961 by the amount of $6,082,138 and for the year 1960 by the amount of $769,850 representing elimination of deductions taken in the returns as filed for said

(521)

years for gas prepayments made or due under take or pay gas purchase contracts.

(c) The addition to taxable income by way of elimination of the amount of the interest deduction which arose in respect of the gas rate refunds made by Gas Corporation during the year 1961.

(d) The addition to taxable income of the amount of $24,354 representing elimination of the loss deducted in the 1961 return attributable to the operation of Overseas, a company the activities of which are non-regulated and unrelated to the activities of United.

Q. Will you explain your reasons why you believe to be correct the adjustments referred to in your answer as (a), (b), (c), and (d).

A. As to adjustment (a): If the five-year average technique is to be employed in establishing a tax rate which is to be applied for rate determination purposes applicable to future years, the income figures of the five-year period should be stated on a basis which reflects the facts and conditions as they are known today affecting the

522

(End of Page 11)

taxable income of the respective companies for the respective years. Hence, for the purpose intended it appears appropriate that adjustment be made reflecting rate refunds by Gas Corporation and by United in the various years to which such refunds are known to apply. As to adjustment (b): The deductions taken in the 1960 and 1961 returns for gas prepayments, that is, the deductions relating to take or pay gas purchase contracts; were so taken because of the technical requirement of the tax law to the effect that a liability must be accrued and deduction taken therefor in

the year when the fact of such liability is established and the amount thereof can be determined with reasonable accuracy. This rule, while technical in nature, is nevertheless an important tax rule and must be observed in order to avoid possible future adverse tax consequences. However, on the books of account these items were treated as deferred charges, and they have not been included in cost of service to the ratepayer for the year during which the deductions had to be taken for tax purposes nor in the test year cost of service in this proceeding. Therefore, no part of the reduction of tax brought about by the deductions should affect the federal income tax expense component for the cost of service in this proceeding. Of course, as either gas taken in makeup occurs or there is a forfeiture of the gas prepayment and to the extent that such makeup or forfeiture is chargeable to

523

the ratepayer, an appropriate counter adjustment in federal income tax expense necessarily must be made. As to adjustment (c): The interest expense incurred by Gas Corporation as a part of the gas rate refund is in no

(End of Page 12)

way chargeable to the customer but is a charge which in fact has come out of the pocket of Gas Corporation's stockholders, hence there is no basis for assigning any part of the reduction of tax because of such interest expense to United's ratepayers. As to adjustment (d): The loss operation of Overseas, an unregulated company, is in no way related to the activities of United and under no theory is it chargeable to the customer, but rather is a charge which again comes out of the pocket of Gas Corporation's stockholders, therefore there is no basis for assigning any reduction in tax as a result of such loss to United's ratepayers.

(523)

Q. As to the comments you have made in reference to the exhibit you have presented, will you please identify the schedules in which appear the various items you have described?

A. The items upon which I have commented appear in Schedules Nos. 3 to 7, inclusive.

Q. Do you have any other comments in respect of Exhibit 14-1 you have filed?

A. Yes. I would like to comment briefly concerning the figures which appear on Schedule No. 1 of my exhibit.

524

These figures show a tabulation of the taxable income of United and the portion of the related consolidated tax allocated to United for each of the years 1957 to 1961, inclusive, with a resulting "effective rate" as to each year. The schedule also shows an arithmetical average of the taxable income figures for the five-year period and a similar arithmetical average of the portion of the consolidated tax allocated to United

(End of Page 13)

for the five-year period. By dividing the averaged taxable income by the averaged tax figure, a mathematical result of 51.749 percent is obtained characterized by the Staff and Memphis witnesses as a weighted average effective tax rate. In presenting this schedule, I should like to make it clear that I do not suggest that this is a proper way to compute an "effective rate" on a five-year average basis; but my Schedule No. 1 has been presented in this form solely for purpose of comparison with schedules presented by Staff and Memphis witnesses which show five-year average effective rate computations made on the same basis as shown by Schedule 1 of my exhibit. The data which appear on Schedule No. one of my exhibit are derived from Schedules Nos.

3 to 7, inclusive, of the same exhibit. The latter schedules show the various adjusments which I have previously described in detail.

Q. In your answer you stated that the method which,

525

appears on Schedule No. 1 described by Staff and Memphis witnesses as a weighted average method, is not the proper way to compute a five-year average "effective rate" if an "effective rate" is to be determined. Will you state what you believe to be a proper way to compute a five-year average "effective rate," if one is to be used?

A. The computations which appear on Schedule No. 2 of my exhibit demonstrate the proper method to be employed in computing an "effective rate" based on a five-year average. The appropriate starting point for a correct five-year average tax rate is the average of taxable income for the five-year period for each of the companies in the consolidated return during such period. This

(End of Page 14)

average is shown in Schedule No. 2 for each company and these separate company taxable income figures when aggregated in the conventional manner produce a consolidated taxable income on an average basis. At this point I should like to emphasize that the amount of income tax expense is a result of two elements, to-wit: Taxable income and the tax rate. The tax rate when applied to taxable income produces the amount of income tax expense. On Schedule No. 2 the statutory rate of 52 percent is applied to consolidated taxable income. The resulting consolidated tax is then allocated to the individual companies on the ratio of each company's separate company

526

taxable income to the "aggregate consolidated taxable in-

come of companies having taxable income." Since each of the companies on Schedule No. 2 has taxable income included in consolidated taxable income at the 52 percent rate, the "effective rate" as to the portion of the consolidated tax allocated to each company is, of course, 52 percent. Hence, if federal income tax expense is to be determined by use of an effective rate, calculated on an average basis, the only averaging which should take place is that of the taxable income itself and nothing else. This demonstration shows that even under the five-year average technique and without taking into account such items as non-utility losses and the like included in the figures used, the effective rate on an overall properly computed weighted average basis for the five-year period still remains at 52 percent, which, of course, is the rate which we have claimed should be used in the computation of the federal tax expense component.

(End of Page 15)

Q. Referring to the exhibit entitled "Computation of Federal Income Tax Alternate Methods," submitted by Staff Witness Warner as part of his testimony, specifically Schedule No. 1 thereof, you have commented earlier in your testimony upon the use of the effective rate of 49.69 percent of taxable income in the computation of the amount of federal income tax expense proposed by the Staff as part of the cost of

527

service. Do you have any further comments concerning the application of this rate when applied to the taxable income of United?

A. Yes. Since the statutory tax rate is 52 percent, the use of a lower so-called effective rate has the effect of ascribing to United tax deductions, which when applied

in reduction of United's taxable income would produce the same amount of tax computed at the statutory 52 percent rate as is produced by use of the 49.69 percent rate when applied to United's taxable income without such deductions.

Q. Will you please amplify your explanation on this point?

A. The taxable income of United used for the purpose of computing federal income tax expense includible in cost of service takes into account all of the deductions to which United is entitled in its own right, excluding, of course, those deductions to which I have previously referred as to which adjustment should be made for a proper result for the purpose of this proceeding. Further tax deductions, when applied in computation of United's taxable income, would reduce such income so that when the statutory rate of 52 percent is applied thereto the result in terms of amount of tax would be the same as the effective

(End of Page 16)

tax rate of 49.69 percent when applied to United's taxable

income without benefit of these extra deductions. This means that the effect of applying a tax rate lower than the statutory 52 percent rate in establishing the federal income tax expense component is to ascribe to United the tax benefit of deductions from a source other than those arising in respect of its own corporate operations. A simple example will demonstrate my point here. Assume an established taxable income figure of $1,000. An effective rate of, say, 48 percent applied to this income produces a tax of $480. But as I have previously testified, income tax expense can only be the result of taxable income times tax rate. The corporate tax rate applicable

by law to United is 52 percent. A tax of $480 and a tax rate of 52 percent means taxable income of $923 (i.e. $923 x 52 percent equals $480). Thus an estimated taxable income figure of $1,000 becomes $77 less, or $923 under the effective rate technique. The Warner Exhibit No. 19-1, Schedule No. 1, if modified to eliminate the investment credit adjustment of $2,100,000, will produce a taxable income figure of approximately $21,545,000. This figure is obtained by applying the conventional percentage factors as shown on the Warner Schedule No. 1 to the 6½% percent return and tax deduction figures indicated on that schedule. The resulting tax at the Warner Schedule effective rate of 49.69 percent is $10,700,174 as shown by my Exhibit 14-5, titled "Computation of Federal Income Tax in Docket RP63-1 using Staff

529

Witness Warner's Formula." This amount of tax at a 52 percent tax rate represents taxable income of approximately $20,577,000. Thus the established taxable income figure of $21,545,000 becomes $968,000 less under the 49.69 percent effective rate.

(End of Page 17)

Using the same taxable income figure of $21,545,000 but applying thereto the Smith effective rate of 48.537 percent the resulting tax amount is $10,457,000. At the 52 percent tax rate this tax amount represents taxable income of approximately $20,110,000. Hence, the reduction in the established taxable income figure of $21,545,000 is $1,435,000.

In other words, by use of the respective effective tax rates of 49.69 percent and 48.537 percent applied to the taxable income figure derived from the Warner exhibit as I have described, United's customers would be given

the benefit of theoretical tax deductions from sources other than United's own operations of between $968,000 and $1,435,000 depending upon the effective rate applied.

Q. You say that the indicated theoretical deductions given to United on the basis you have outlined would derive from sources other than United's own operations. What other sources would be available from which such a deduction could be secured?

A. The only other source for such deductions would be to impute to United tax deductions which in fact are those of

530

one or more of United's affiliates included with it in the consolidated returns filed. But under the Staff and Memphis witnesses' five-year average method of computing the effective tax rate, I would like to point out that the taxable income of Union and Gas Corporation on the same five-year average basis is not a loss figure but is in fact an income figure, as shown on Schedule No. 2 of my exhibit. Therefore, the indicated fictitious tax deductions which must come from some other-

(End of Page 18)

source for the benefit of United simply are non-existent. The only other conclusion which can be drawn from this analysis of the real effect of use of the effective rate technique is that the Staff and Memphis are assuming that such losses will arise in the future as a regular recurring circumstance and if they arise can be imputed to United. There is, of course, no basis in fact for such an assumption. Thus these are phantom tax deductions.

Q. Would the same amount of phantom tax deductions arise if any of the additional tax deduction adjustments claimed in the Warner and Smith exhibits were allowed in

computing taxable income for federal tax expense component purposes?

A. The phantom deductions would arise, but not in the same amount. True to their phantom-like character they would vary with the amount of taxable income ascertained under any

531

given assumption as to allowable tax deductions. This of course is further indication of the fallacy of the whole effective rate technique.

Q. In addition to the adjustments indicated by your Exhibit No. 14-1 have the figures there shown been adjusted for any other items which you would consider appropriate?

A. No. In the interest of avoiding undue complication we have not undertaken to show the effect of the elimination as deductions of such non-utility losses as those arising from Gas Corporation's merchandise and jobbing department and its instruments division. There are other similar items.

(End of Page 19)

Q. Why, in your figures, have you not made adjustments for these items?

A. They have been omitted largely in the interest of a simplified presentation. But by such omission I do not wish to convey the impression that in our view appropriate adjustment for such items in determination of the federal tax expense component should not be made. The exhibit and schedules to which you refer have been presented for the purpose of demonstrating the invalidity of

the effective rate technique. We believe this objective has been accomplished by the exhibit without resorting to refinements of further but nevertheless appropriate adjustments.

Q. Earlier in your testimony you explained that the

532

inclusion of the losses of Union in the consolidated returns filed by Gas Corporation and its subsidiaries are generally responsible for the so-called effective rate result which the Commission Staff and Memphis seek to apply. Is this correct?

A. Yes.

Q. Do you have any further comment concerning the effect of Union's losses upon the consolidated tax return?

A. I would like to point out that whatever amount may be included in cost of service as to United for gas purchased by it from Union necessarily must include recognition of Union's federal income tax expense component in the cost of such gas. I am aware that Staff counsel has made the observation that no allowance should be made for such cost factor since Union, according to Staff counsel, has a tax liability only about once every five years. I do not agree

(End of Page 20)

with the Staff's position on this point but if there is no federal tax component recognized in the cost of gas purchased by United from Union, its omission is due to Union's net loss for tax purposes. As the schedules show, which are a part of the exhibit I have presented, Union's tax net loss should be segregated in the first instance be-

tween Union's oil and gas operations, respectively. Furthermore, the loss attributable to Union's gas operations is completely absorbed by Union's

533

taxable income from such operations in other years during the five-year average period used by the Staff to establish an effective tax rate. It must follow from this that no part of Union's gas operation tax losses should affect the tax rate applicable to United's taxable income. This, of course, is only another way of pointing out the fallacy of any federal income tax rate applicable to United's taxable income other than the statutory rate of 52 percent. And, finally, not all of Union's losses in any event are referable to its jurisdictional gas sales since about 25 percent of Union's gas revenues are derived from non-jurisdictional sales.

• • • • • •

2808

Excerpts from testimony of E. L. Dunn, a witness for UGPL Co.

Cross-Examination

BY MR. BERKELEY:

Q. Mr. Dunn, is it not correct that United Gas Pipe Line Company does not file a separate income tax return, but rather joins in a consolidated income tax return which includes United Gas Corporation, United Gas Pipe Line, and Union Producing Company?

A. I believe that is fully explained on my direct, but each of the companies in a consolidated return do prepare a separate return, and then it is consolidated to form a consolidated return.

Q. But the actual dollars of tax paid by United Gas Pipe Line, or any other constituent member of the consolidated tax filing group are determined by the taxable income after inter-company eliminations shown on the consolidated tax return, is that correct, sir?

A. I don't believe that is the way the law is. Each company is fully liable for its own taxes in the consolidated group.

Q. Is it not a fact, Mr. Dunn, that if you want to know the total dollars of tax paid by UG Corp., Union Producing and United Gas Pipe Line, you must look to the total consolidated

tax income and total consolidated tax shown in the consolidated return?

A. Would you read that, please?

(The question was read.)

THE WITNESS: Well, you have taken three companies and added them together to get a total. Now, the consolidated tax shows the consolidated total tax.

BY MR. BERKELEY:

Q. All right, sir. You said before that each of the three companies prepares a separate tax return?

A. Yes.

Q. On that separate tax return there will be a figure called net taxable income for United Gas Pipe Line, and

there will be another one for Union Producing, net taxable income of Union Producing, and another for United Gas Corporation, excluding, now, years beginning in 1961 when you have Union Producing Overseas — ignoring them, you add the other three together. Those separate net taxable figures will always be greater than the amount of consolidated tax income and tax shown on the consolidated tax return, is that not correct?

A. That is not necessarily true.

Q. Can you cite me to a year in which it was not true?

A. Well, I would have to go back and check prior years, out obviously —

Q. I am agreeable to your supplying the information.

2810

A. Obviously, it cannot always be true, because any non-regulated company is subject to a two percent penalty in filing or joining in a consolidated return, so that it is not necessarily true under the tax laws that filing a consolidated return makes the total tax less for all the companies on a consolidated basis than it would be for the companies on a separate return basis.

Q. Is there any other reason you could give to support your statement other than the two percent penalty applicable only to Union Producing Company?

A. No, I can't think of any reason why the consolidated total tax should be any different from the three separate returns tax except the savings of fifteen percent of inter-company dividends, and the fact that in any one year the total tax does not reflect the right of the indi-

vidual companies to carry forward or carry back tax losses.

Q. All right, now, turning back to the question of the two percent penalty, do you know the maximum dollar amount of the two percent penalty because Union Producing, which is not a regulated company, participated in the consolidated tax return in any year between 1956 and 1961, and by "maximum" I mean the greatest amount in any of those years, the greatest dollar amount.

A. Well, it may well be shown on the detailed material we furnished, but I can't recall offhand. It is two percent of

their taxable income.

Q. What was the highest taxable income that Union Producing Company had in any of those five years, Mr. Dunn?

A. Well, again that is shown on my exhibits.

Q. Which exhibit, sir? I would like to look at it.

A. I believe the highest year in the last few years was in 1958.—

Q. Excuse me, Mr. Dunn, I asked for the period '56 to '61, the highest in that period.

A. Well, in that period, it would be the year '58.

Q. All right, sir, which exhibit are you looking at now?

A. Exhibit 14-1, Schedule 9.

Q. Well, if I understand Schedule 9 correctly, it is the amounts attributable to oil and gas.

(2811)

A. Well, it is the total, alto — total taxable income for the year 1958 for Union is $4,996,503. That is shown in the lower righthand corner.

MR. SPIEGEL: Can you give us the line and column in that, sir?

THE WITNESS: Well, it is Column 9, line 36.

MR. SPIEGEL: And that is Schedule 9?

THE WITNESS: Schedule 9.

MR. SPIEGEL: Will you give us just a moment to find these things?

2812

PRESIDING EXAMINER: Yes.

BY MR. BERKELEY:

Q. Would you accept subject to check, Mr. Dunn, that two percent of that highest maximum taxable income reported by Union Producing in the five years between 1956 and 1961 is $97,055?

A. That sounds pretty close.

Q. And that is the increase in tax that results from the participation of the three companies in a consolidated tax return, is that correct, sir?

A. Yes.

Q. Now, as opposed to that, we have the tax savings due to Union Producing Company losses. What was the maximum loss, tax loss on its separate net taxable income

schedules reported by Union Producing in the five years between 1956 and 1961, sir?

A. Union has never had any tax savings —

Q. Tax loss, excuse me.

A. Union has never had any tax loss. Union was able to utilize all of its tax deductions, as we show in our exhibits, during this period you are talking about.

• • • • •

2829

• • • • •

Q. Mr. Dunn, in your Exhibit 14-1, for the year 1957, Schedule No. 3, there is a reported separate net taxable income for United Gas Pipe Line Company per Revenue Agent's Report of $25,708,049.

A. That is correct.

Q. And I have an Exhibit L to United's 1957 calendar year tax return which shows on page 67 a reconciliation of income, United Gas Pipe Line Company, and shows at the last line net income separate return basis, $25,602,479, and the difference is only $105,000.

Am I to take it, then, that whenever there is a figure on the tax return that is called "Separate return basis, net income per return", those would be the figures from which you derive your net taxable income as shown in your Exhibit 14-1?

A. Yes. I am sure that that must be correct. I haven't seen the figure to which you refer, but the only figures

in which the Revenue Agent's Report and the return filed have substantial differences are with respect to Union Producing Company's tax return.

Q. I take it that the way in which that figure that you start off as net taxable income in each of your schedules of Exhibit 14-1 is computed is to take the separate gross income for the corporate entities involved, subtract from it the tax deductions for that entity, add to it a category known as additions to income, and offset against it a category known as reductions of income, and that that is the method by which this separately determined net taxable income figure is produced?

A. Well, those items as related to the particular company, yes, it is all the income that is required to be reported as income or revenues less the tax deductions which are authorized by law.

Q. In other words, Mr. Dunn, United follows the policy — when I say United, I mean the entire corporate complex — of filing in essence three separate tax returns, a separate tax return showing separately computed net taxable income for each of the corporate entities that participate in the return?

A. Well, I don't believe you would really describe it as filing three separate returns, separate returns are prepared and then consolidated and a consolidated return

is filed, of course, along with all the supplementary data that goes into that consolidated return.

Q. So the only thing that is filed with the Commissioner of Internal Revenue is one consolidated return?

A. Plus all the supplementary data, including the necessary data to arrive at the consolidated return which would necessarily include the separate taxable net income of each of the participating companies.

• • • • •

2848

• • • • •

Q. When United reports — when United Gas Pipe Line Company reports its tax paid, or tax expense for each calendar year to the Federal Power Commission annually, what is the basis on which it determines the tax expense of United Gas Pipe Line Company which participates in a consolidated return and does not file an individual return?

A. That is an accounting matter, and obviously tax returns have never been filed by United, as far as I know, when the Form 2 is reported to the Federal Power Commission,

2849

so that it is an estimated figure, and the accounting department obviously would be the one to answer questions as to how they report Form 2.

Q. Isn't it a fact, Mr. Dunn, that they use the allocation method described at page 506 of your testimony in

spreading the consolidated tax to the different companies participating in the consolidated tax return?

A. Well, it is my understanding that, just as I state it here, and you just read the testimony. It says although we recognize the result I have described, I am aware that some other allocation could be used for book accounting purposes, we felt it is better to allocate the consolidated tax in accordance with the rules prescribed by the tax law in the computation of earnings and profits of the respective companies which are included in the consolidated return.

Now, that does say that that particular procedure was used for book purposes, for book accounting purposes. Now, of course, the amounts are different from what appear on the tax return, because the tax return has not been filed when the books are closed.

Q. Then would it not be a correct statement that the tax expense for United Gas Pipe Line Company as booked in accordance with the FPC system of accounts, and as reported annually to the Commission, is predicated upon an allocation of consolidated tax to the different tax filing —tax

2850

reporting entities included in the consolidated return in accordance with the method described at page 506 of your testimony?

A. Yes.

• • • • •

2855

• • • • •

Q. How does United Gas Pipe Line Company determine the amount of tax which it shall pay to United Gas Corporation at the end of each year for the UGPL tax liability portion of the total consolidated return tax liability?

A. That is an accounting — that is a matter handled through the accounting department. To get the correct answer, you just ask — Mr. Luke was here and could have given you the answer.

Q. You are the tax witness, and Mr. Luke conscientiously refrained from tax questions.

PRESIDING EXAMINER: Let's not argue about it.

Do you know how this was done? I believe the testimony was that there is a common accounting department.

2856

THE WITNESS: Yes, and, of course, it is a simple matter to transfer the necessary funds to meet these tax liabilities. Now, my understanding of it is — I didn't go into it particularly, it is not important to me, and has nothing to do with this rate case — if memory serves me right, the cash is simply transferred in accordance with the allocation that I described on page 506 of the transcript. That is done for accounting purposes as well as tax purposes, and as explained that is a reasonable method of disposing of this inter-company problem.

MR. BERKELEY: If I understand the answer, Mr. Examiner, the witness has now answered the question.

PRESIDING EXAMINER: Then let's proceed.

BY MR. BERKELEY:

Q. If you discover that you are incorrect in your answer by consultation with Mr. Meece or others who might know, will you please let us know?

A. I will.

2857

MR. FLETCHER: I can correct it for you now, Mr. Berkeley. He is in error.

Each company writes its own check for its own share of the tax and pays it to the Director of Internal Revenue.

Don't shake your head at me — that is the fact.

MR. BERKELEY: We apparently had a misunderstanding. I don't care who pays the tax. My question is how does United Gas Pipe Line Company decide how much money it shall pay for its share of the tax, and I don't care whether it writes the check to the Commissioner of Internal Revenue or to United Gas Corporation.

MR. FLETCHER: That was your question.

PRESIDING EXAMINER: All right, the witness' answer is on record here. Let's proceed,

BY MR. BERKELEY:

Q. Now, if I understand your exhibits and direct and rebuttal testimony correctly, it reduces to a basic and simple proposition that the tax allowance made by the Federal Power Commission in a pipeline rate case for a company which participates in a consolidated tax return should not reflect any savings, if savings did exist as a result of the filing of a consolidated return — is that correct, sir?

A. I deny that there is any savings from any other company, because I know there has not been, but your question was an "if" question.

2858

Even if Union did have some tax savings from its oil operations, I do not know why they belong to any customer buying gas from United.

The fact is that all of Union's oil losses can be used up by its oil operations, so there is nothing available from the oil operations to give away to United Gas Pipe Line's customers. They are not entitled to it, there is nothing to give, and it is just an absolute confiscation of property the way the staff has attempted to give those oil losses to customers of United Gas Pipe Line Company.

2859

• • • • • •

Q. In your opinion as an expert witness appearing for United, Mr. Dunn, would it be a fair procedure for the Commission to determine the taxable net income of United Gas Pipe Line Company on the assumption that it is a separate company filing a separate tax return?

A. You don't have to make any assumptions in determining fair income for utility operations. You take the facts and relate them to the property that is in the rate base. You don't go around just taking a company and disregard the fact that its operations may or may not be subject to regulation.

Q. And the facts are, as you see them, that United Gas Pipe Line Company is separately operated, and therefore should not have the benefit of any Union Producing Com-

pany tax deductions which result in tax losses, for the benefit of any United Gas Corporation tax deductions which result in tax losses, correct?

A. I don't know what you mean by benefit of tax losses. Union can use its own tax losses, and the customers haven't any claim on any oil tax deductions in any way, shape or form under the guise of so-called tax losses, or for any other reason. Those tax losses belong to Union, and the only tax

2860

deductions that need to be considered in a rate case are those tax deductions that arise from the investment and expenses that are included in the cost of service.

Q. Perhaps we can get at it in a simpler manner. This is a fairly non-controversial subject.

You state that Union is entitled to its own tax losses, and United Gas Corporation is entitled to its own tax losses, and of course United Gas Pipe Line Company should be entitled to its own tax losses?

A. They don't have tax losses. I can't answer that question. These companies haven't had tax losses. United Pipe Line doesn't have tax losses in any year.

Q. United Gas Pipe Line Company never has tax losses because as soon as it is threatened with loss of income it files promptly for a rate increase, is that correct, sir?

MR. FLETCHER: Oh, Mr. Examiner—

MR. BERKELEY: It has a legal right—

PRESIDING EXAMINER: Please, Mr. Berkeley, you are not on the stand. Let's proceed.

BY MR. BERKELEY:

Q. Isn't it correct that the only way in which a company can legally keep separate the tax loss in a given year that belongs to any of the companies that participate in a consolidated tax return is not to file a consolidated tax return, Mr. Dunn?

2861

MR. FLETCHER: Now he has called for a question of law. I object. If he asks a question of mechanics, let him answer. He says isn't it true the only way they can legally do it—

MR. SPIEGEL: I object to the objection on the grounds that this witness has put in legal testimony. I objected to it, the Examiner refused to strike it, and it seems to me you have got to allow some leeway to counsel to ask some legal questions. Either that, or you have said that our cross examination should be in the brief, and I think this kind of direct testimony should be in the brief.

PRESIDING EXAMINER: Please, counsel, let's proceed with the examination.

MR. FLETCHER: I sure would like to answer that.

MR. BERKELEY: I have a question pending.

PRESIDING EXAMINER: All right, would you read the pending question?

(The question was read.)

PRESIDING EXAMINER: All right, we will strike the word "legally", and you may answer the question.

THE WITNESS: Well, the question is pretty garbled.

MR. BERKELEY: will make it more specific.

BY MR. BERKELEY:

Q. Union Producing Company in several years has had negative tax income — in other words, an excess of tax deductions over tax income, correct, sir?

2862

A. Yes.

Q. In these years, there was a consolidated tax return filed in which the total aggregate separate net taxable income of United Gas Corporation and United Gas Pipe Line Company was reduced by the fact that Union Producing Company had a net tax loss in that year, isn't that correct, sir?

A. Well, you talk about being reduced. It is because in a consolidated return you reflect all revenues and all tax deductions. You only owe so much tax.

Now, what has been reduced? You have one tax figure. There is nothing reduced by that tax figure. It is a tax figure that reflects only the elements of revenues less expenses. That produces a tax figure.

Some of those expenses came from Union, some of those expenses came from United Gas Pipe and some from United Gas Corporation. The same way with revenues. Now, there is no co-mingling or loss of identity of any item. Each item to be supported in a tax return must be described, the nature of it disclosed, supported by expenditures, all the detail

required by the Bureau, so that there is no loss of identity of any tax deduction or any item of revenue in a consolidated return.

Q. And isn't it a fact, also, Mr. Dunn, that when Union Producing Company, or any other member of a tax filing group has deductions which exceed its taxable income for a given year that the benefit of these loss deductions by carry-back or

carry-forward can only be against the aggregate consolidated tax income of all members of the group in earlier years or later years?

A. There is no need to have a carry-forward or carry-back unless you need it. That is the purpose of having a consolidated return. That is why the law allows a consolidated return so that you can reflect currently all of your deductions.

Now, if you have more deductions than you can use, the law goes farther and permits you to carry those deductions back three years, and if you can't carry them back three years you may carry them forward five years.

Q. But isn't it true that this carry-back and carry-forward takes place only on a consolidated basis?

A. If the consolidated basis is sufficient — I don't understand the word "only". However, in order to avoid any confusion about this problem, I have made a study of the separate returns to see whether Union, itself, on a separate basis was able to use all of its tax deductions, and that study proves conclusively that whether a consolidated re-

turn basis is used or a separate return basis is used, Union, itself, can use all of its tax deductions. Therefore there is no tax loss that is ever of any use to the other two companies.

PRESIDING EXAMINER: But, Mr. Dunn, I don't think you are answering this particular question.

If the aggregate files a consolidated return this year,

2864

and if next year it wants to carry forward or carry back, it cannot do that on an individual return basis, can it?

THE WITNESS: I wouldn't assume so.

PRESIDING EXAMINER: It has to be filed on a consolidated basis.

THE WITNESS: I am sure Mr. Gilpin can answer that question. He is a tax attorney.

MR. SPIEGEL: Is your answer that you don't know?

THE WITNESS: I wouldn't be positive about it. We never have to do that, because I don't recall, except for very minor items that are ever carried forward or carried back. There are some special tax treatments with regard to things such as contributions, charitable contributions —

BY MR. BERKELEY:

Q. Mr. Dunn, that is beside the point. I have a very simple question. I am trying to find out what United Gas Pipe Line and United Gas Corporation have actually done in the years from 1956 to 1961.

Isn't it a fact in those years that on its tax return, when there has been an aggregate of tax deductions over tax income for Union Producing Company, they have used that

tax loss in the year in which it occurs to wipe out or eliminate or offset taxable income of United Gas Corporation and United Gas Pipe Line Company — isn't that correct, sir?

A. Well, now you are on a separate versus a consolidated

2865

basis. As you just pointed out, there is only one taxable income when the tax return itself is filed, and that is composed of revenues and tax deductions from all three sources. They are all used, and the figure is a consolidated taxable net income, and that is used currently.

Now, you were talking about carry-forwards and carry-back within this five year period, and I say that only very minor amounts due to charitable contributions had special tax treatment with respect to them.

Q. But even if there had been some, or to the extent there were some, they were still dealt with on a consolidated basis, were they not?

A. That is my understanding, but we haven't had it, and as to all the ramifications of the tax law on that Mr. Gilpin can tell you.

Q. As I understand the purport of your testimony, however, you are saying this. You are saying it is just not equitable, irrespective of the law, that a tax loss generated by the operations of Union Producing Company should be used to reduce the tax payable by the ratepayers of United Gas Pipe Line Company, because they are two separate unrelated operations, is that correct?

A. No, that really isn't my testimony. My testimony is that when Union, itself, can use its tax losses and when

Union, itself, is partially subject to regulation that whatever tax

2866

deductions Union has should be considered in Union's rate case, and have been considered in Union's rate case in the test year '58, and I came along and found the staff of the Commission trying to use them again in United Gas Pipe Line's rate case — in other words, use them twice.

Furthermore, they went to oil operations, and they tried to use oil operations to give to Union's customers, and then they went to the oil operations again and tried to give them to United Pipe Line's customers.

Now, with respect to the use of Union's tax deductions, the Commission certainly under the law, under regulation, can consider those tax deductions and those statutore tax deductions for percentage depletion that related to gas, but whether the Commission can take oil percentage depletion and oil well drilling costs and tax deductions related to oil and give them to the gas customers is something that would have to be approved by the courts. I don't think any company would consent to that.

Q. Well, you have so many considerations in your answer, Mr. Dunn, I am puzzled where to begin, but I want to pin one simple concept down.

If I understand your testimony correctly, and I am trying to get the bare essentials and leave out the petty details, your basic philosophy about this is that if Union can get the tax benefit of the savings itself they shouldn't be used for anybody else's purpose. In other words, if we had a situation where

2867

Union never had any tax income, you would then agree that

it could be used by United Gas Pipe Line and by United Gas Corporation?

A. Well, I don't understand what you mean by never had any tax income. The Commission will have to fix rates for Union, since it is subject to regulation, and it will use Union's tax deductions to fix Union's rates.

Now, I object to your assumption that Union's tax deductions can be used again to reduce United's rates. If they are used to fix Union's rates, they are not available to use to fix United's rates, and as far as oil tax deductions, they are not available to any gas customers.

• • • • •

2878

• • • • •

Q. Isn't it also a fact that several exhibits prepared by Mr. Meece initially and sponsored by you refer to 1962 budget in this case, and 1962 estimated tax for nine months of the year?

PRESIDING EXAMINER: Well, can we have a reference to a specific exhibit?

MR. BERKELEY: Exhibit 14-6, Mr. Examiner, as prepared by Mr. Dunn is designed to show the tax effect of the 1962 rate refund. Before Mr. Dunn could prepare this exhibit, he knew that the refund was 35 million. He knew that at a 52 percent tax rate that is worth about 18 million dollars. He had to know what the total aggregate consolidated gross income —

PRESIDING EXAMINER: Why don't you ask him what that figure is? I assume it is in the record somewhere.

2879

MR. BERKELEY: I have asked him, and he says he didn't know it at the time he prepared the exhibit.

PRESIDING EXAMINER: All right, do you know?

MR. FLETCHER: Mr. Examiner, if you will indulge me, Exhibit 14-6 on its face is an estimate for 1962 only as to United Gas Pipe Line Company.

Now, I am trying to get the exhibit number right now, which I think is 2-45 — have you got that, Mr. Dunn?

THE WITNESS: Yes.

MR. FLETCHER: That is in the filing, and that does have an estimate, but it is an estimate, and I call the attention of the witness to Exhibit 2-45.

MR. BERKELEY: Mr. Examiner, it is right in Mr. Dunn's Exhibit 14-6. He has a column, and at the end of it the first note says 1962 estimated tax liability of United Gas Pipe Line Company on consolidated return basis before giving effect to the rate refund deduction, and that figure is shown as $7,640,000. That is physically impossible to allocate part of a total consolidated tax —

PRESIDING EXAMINER: Let's stop arguing about this, and get the figure on the consolidated return estimate. We are just going around in circles.

MR. BERKELEY: I will ask it again.

BY MR. BERKELEY:

Q. Mr. Dunn, turn to your Exhibit 14-6, please, the

first note following the table refers to a 1962 estimated tax liability of UGPL on a consolidated return basis before giving effect to the rate refund deduction.

Before you could arrive at that figure, which obviously represents an allocation of estimated consolidated tax for 1962, you must have arrived at an estimated consolidated tax for the entire system for 1962. Please give us that figure.

PRESIDING EXAMINER: All right, we will take our recess at this time, and when we come back, let's hope we can proceed.

(Whereupon, at 3:30 p.m., the hearing was recessed until 3:42 p.m.)

2881

PRESIDING EXAMINER: May we come to order, please?

Do you have the answer, Mr. Dunn?

THE WITNESS: I checked on one answer Mr. Berkeley asked concerning the billing between companies for the consolidated tax.

When the taxes are accrued, they are distributed in accordance with this method which I have described as being a method used for tax purposes, and each company then sends its own check to the Bureau of Internal Revenue, so there is no inter-company billing.

Now, in the event that later on the taxes are underpaid, that underpayment is allocated in the same way, and a check is sent to the Bureau of Internal Revenue.

Now, if in some later period there is a refund, that refund is taken to the year in which it applies. The taxes for that year are recomputed, and the refund is also applied to the companies on the basis of the reallocated tax.

(2881)

BY MR. BERKELEY:

Q. Then do I understand your testimony correctly that the various rate refunds shown as a reduction of United Gas Pipe Line Company's separately computed net taxable income in the second line of your Schedule 3 to 7, inclusive, of Exhibit 14-1, represents sums of money which United Gas Pipe Line — which United Gas Corporation

2882

and its subsidiaries will pay back to United Gas Pipe Line Company?

A. Well, actually it will be the Treasury Department that pays it back, because the money was paid to the Treasury Department, and actually that figure shows much clearer again on 14-6.

The first part of it, that Schedule 14-6, shows that United Gas Pipe Line Company, if its tax had been assigned to it at the full 52 per cent rate instead of this allocated basis, would have gotten back $15,364,328, but taking the refund and reworking it to the year shown, namely reworking it for '62 in its entirety, and for the year '59, they only get back $13,443,083.

Now, that is because it was not charged with the full 52 per cent tax due to the allocation, and therefore the refund is something less than a full 52 per cent tax, the refund being computed exactly as the original tax was computed.

Q. And the tax saving or reduction in taxes due to the refund will be on the order of 18 million, will it not, or 52 per cent of the 38 million dollar figure, so that the difference between roughly 18 million and $13,443,000 will be

retained by other members of the tax filing group, such as United Gas Corporation and Union Producing, is that correct, sir?

A. Oh, no, the tax overpayment at 52 percent was

2883

$15,364,328, but the overpayment on the basis of the allocated tax of United Gas Pipe Line was $13,443,083. That is simply the consolidated effective tax rate as computed by means of an allocation procedure working in reverse. It is charged too little tax, you get back something less than the full 52 per cent of the tax.

Q. What is the percentage, Mr. Dunn? You said the tax saving wouldn't be computed at 52 per cent, but would be computed at the percentage that had actually been charged in the allocation of consolidated tax to United Gas Pipe Line Company.

What will that percentage be, sir?

A. Well, for the year 1959, it would be the percentage — whatever it works out to be. It is worked out on a dollar basis, not a percentage basis. We allocate total tax on the basis of taxable net income, and those are dollars. In the year '59, the total amount of tax liability after giving effect to the loss carryback deductions for 1962 is the figure of $4,177,782. Now, that represents an allocation of 87.692 per cent of the total tax to pipeline company, 12.308 per cent to corporation, and nothing to Union for that year.

Q. We are getting ahead of ourselves, Mr. Dunn.

I was after a simple question. I was after how much cash will United Gas Corporation and its subsidiaries as a

single unit receive from the Federal Government by virtue of the carryback? Have you a figure based on your computations as to that sum of money?

A. $15,364,328, that is the total effect of that — no, I beg your pardon. That may not be. That is the total effect to United Gas Pipe Line Company. There are other effects on the Gas Corporation, because some of that refund went to Gas Corporation.

Q. Do you have with you, Mr. Dunn, so we can simplify the matter, the total dollar amount of the refund of principal and the payment of interest — refund of principal and interest made by United Gas Corporation pursuant to order of the Federal Power Commission on March 16, 1962, made by United Gas Pipe Line on March 16, 1962?

Would it be a total of $35,454,262 as booked by United?

A. I was just seeing if I had it on one of these working papers.

Q. Would you like to look at the sheet Mr. Meece gave me which summarizes it?

A. Well, that is shown on this sheet.

Q. Well, I wish to know if that is correct, sir, not whether it is shown on the sheet.

A. Well, that is what I was saying — I was looking in my working papers for the exact amount. Yes, that is shown in the working papers, $35,454,262.

Q. And is it correct that $29,778,219 of that sum is a refund of principal, and that $5,676,043 of that sum represents interest?

A. That is correct.

Q. All right, sir.

Now, it is obvious that on any theory, the reduction in the total taxes paid by the single consolidated tax return group will be 52 per cent of $35,454,262, is it not?

A. Not necessarily. Some of that refund may go to United Gas Corporation.

Q. My question was directed to the tax saving resulting from the — the tax saving to the consolidated return entity, which comprises United Gas Corporation, United Gas Pipe Line Company, and Union Producing Company, and Union Overseas Producing Company.

Now, with respect to all of them considered as a single tax filing entity, which they are, won't the reduction in taxes due to the making of this refund by United Gas Pipe Line Company amount to $18,436,216?

A. Well, that may be in the working papers. I hadn't computed it for all of them. I computed it only for United Gas Pipe Line Company.

Q. Doesn't it necessarily follow by simple logic that if you have a tax deduction in the amount of $35,454,262, and the corporate tax rate is 52 per cent, that

the availability of this tax deduction to the consolidated tax return group will save it $18,436,216?

A. Not if some of the refunds go to another member of the group.

Q. I am speaking of the entire group in the aggregate. I am not concerned with how they divide the pie.

A. You are off on a different wave length. I was only talking about the refund the Commission ordered on United Gas Pipe Line, some of which goes to United Gas Corporation.

Q. What portion goes to United Gas Corporation in its capacity as a customer — do you have that, sir?

A. Well, I can't tell you offhand. It can be computed.

Q. Isn't it completely immaterial whether it goes to United Gas Corporation or anybody else, because the tax — because the refund of principal and interest is made by United Gas Pipe Line, and it is its action in making the refund of principal and interest which generates the tax deduction?

A. The item is completely immaterial in this rate case, because it refers to years that are not even involved in this rate case, but it is certainly material in filing your tax return as to whether it is ultimately taken out of the consolidated return or does stay in the consolidated return.

Q. Well, I had a question pending which wasn't answered. May I have the question read back, please?

PRESIDING EXAMINER: Mr. Dunn?

2887

THE WITNESS: He asked me if it is immaterial. It is immaterial to this rate case, but I said it was material to the tax return whether or not the money went completely outside the group or whether some of it was retained within the group.

PRESIDING EXAMINER: Well, it seems to me that you keep getting off on collateral and peripheral matters. As I understand the questioning, it is simply directed to the effect of the refund on the tax filing aggregate, without reference to how the money is distributed.

THE WITNESS: How the money is distributed is material.

BY MR. BERKELEY:

Q. It this what you are referring to, Mr. Dunn, that to the extent that the refund was to United Gas Corporation, the corporate entity as a whole will have to eliminate that portion of the refund on the consolidated tax return?

A. Not necessarily all of it. The corporation may have obligations to in turn refund some of the money. They may have no obligation to refund any of the money.

Q. All right, sir, would you please tell me, or supply for the record if you don't now have available the figure, what portion of the total refund of $35,454,262 will be retained by United Gas Corporation and will not result in an eligible tax deduction on the consolidated tax return for 1962?

2888

You must have this figure, because you used it in preparing Exhibit 14-6, did you not?

A. No, I wouldn't need that.

Q. Well, sir, how would you possibly know what the tax effect of a rate refund in 1962 was if you didn't compute the tax deduction that would be available to the consolidated tax filing entity in 1962?

A. Well, the way we computed it here is to first estimate the total tax liability for 1962 without considering the 1962 FPC rate refund.

Q. All right, sir, what was that figure, please? I have asked for that figure three times, and you have had an opportunity during the recess.

A. The figure is $7,647,645.

Q. That is the figure for United Gas Pipe Line, is it not?

A. That is the total figure, also.

Q. Let me ask this question, Mr. Dunn. In preparing Exhibit 14-6, did you attempt to determine what the total consolidated taxable income for the entire tax filing group would be, exclusive of the rate refund deduction attributable to the Commission's March 16, 1962 order?

A. That is the figure I just gave you, yes.

PRESIDING EXAMINER: Pardon me, that is the figure for the aggregate for the consolidated tax return?

THE WITNESS: Yes, sir.

PRESIDING EXAMINER: Not merely for United Gas Pipe Line?

THE WITNESS: Well, you see, it all goes to United Gas Pipe Line, because in 1961 Union had a small loss, and also Corporation had a small loss or estimated loss for 1962, so therefore the only company that had income was Pipe Line, so in accordance with this allocation of allocating — this basis of allocation, we allocated only to the company that had taxable net income, which meant that Pipe Line got all the tax in the year 1962, or the estimated tax in the year 1962.

BY MR. BERKELEY:

Q. Mr. Dunn, you keep speaking of allocations, and I am asking only one simple fact.

Did you or did you not in preparing Exhibit 14-6 make an estimate of the total consolidated taxable income and the total consolidated tax which would be payable in 1962 for the entire tax return group without regard to the rate refund deduction attributable to the 35 million dollar refunds made by United Gas Pipe Line?

A. I just answered that at least twice, that we had, and that the total figure was $7,647,645.

Q. Then the total aggregate consolidated tax for United Gas Pipe Line Company, Union Producing Company, United Gas Corporation, and Union Overseas Producing Company was a

2890

tax of $7,647,000, exclusive of the refund, is that correct, sir?

A. That is the estimate.

Q. And if we took a number and multiplied it by 52 per cent, any number, or the number which when multiplied by

52 per cent yields $7,647,000 would be the consolidated tax income for 1962 as estimated by you, correct, sir?

A. Well, I have the figure here.

Q. Please supply it.

A. The revised taxable income, including dividends, was $14,676,265. That is made up of a consolidated breakdown of the three companies, United Gas Pipe Line Company, $14,117,146, Union Producing Company, $1,074,330, United Gas Corporation a red figure or net loss after eliminating dividends of $515,211.

MR. BERKELEY: Mr. Examiner, may we have those figures read back, please?

PRESIDING EXAMINER: Yes.

(The answer was read.)

THE WITNESS: If I might go ahead, the aggregate of those figures is $14,676,265.

Then on Union there is a two percent additional allocation tax of $21,487, then there is a $5500 surtax credit, leaving the total tax of $7,647,645. That was allocated 92.92 per cent to United Gas Pipe Line in the amount of

$7,106,804, and 7.072 per cent to Union Producing Company in the amount of $540,841. Then following the procedure that since Pipe Line Company gets Union's losses it pays Union's taxes, the $540,000 was assigned back to United Gas Pipe Line Company, bringing the total to United Gas Pipe Line Company to $7,647,645.

Q. All right, sir, what about United Overseas during this period?

A. Nothing was estimated for them one way or the other in this estimate.

Q. Did you make any inquiry as to whether they would be profitable or unprofitable during the year?

A. Nobody knows.

Q. Well, in 1961 you reflect their operations which I believe were unprofitable, isn't that correct?

A. That is right, it is an exploration company, and they may well have a loss, but nobody knows how these are going to turn out.

Q. Last year is it not correct was the first year, 1961 was the first year in which they commenced operations of Union Overseas?

A. Well, it will show in my actual figures for the year's tax returns. As I recall, that was the first year, at least the first year that it appeared in the tax returns.

Q. Isn't it likely that their results would be more

profitable or less unprofitable in the second year than in the earlier year — in the second and third years when they begin drilling and may have some luck in finding profitable wells?

MR. FLETCHER: Mr. Examiner —

PRESIDING EXAMINER: I am going to sustain the objection.

BY MR. BERKELEY:

Q. Did you make no inquiry at all as to the potential tax liability or tax income of United Overseas, Mr. Dunn?

A. I personally didn't. Mr. Barham may have. He collaborated on working on this.

MR. BERKELEY: That is hearsay. I move it be stricken.

PRESIDING EXAMINER: If you ask the question, you are stuck with the answer. Let's proceed.

MR. BERKELEY: Mr. Examiner, I think this computation Mr. Dunn has goes to a very vital element of this case, and I think it would be most helpful in explaining and understanding and evaluating his Exhibit 14-6 that we have that worksheet that he has been reading from. Otherwise, we will have great difficulty in digging it out on cross examination, whereas if it is available, everybody can quote it in the brief and we won't have any difficulty, sir.

PRESIDING EXAMINER: Do you have any objection, Mr. Fletcher?

MR. FLETCHER: If he wants to offer it, I don't.

2893

MR. BERKELEY: Well, it is part of a worksheet.

MF. FLETCHER: You can offer it if you want to.

PRESIDING EXAMINER: Nobody is objecting.

MR. BERKELEY: I would like to offer it in evidence, Mr. Examiner Can it be marked for identification and can Mr Dunn supply us a copy so we can have it reproduced?

MR. FLETCHER: He will lend you his copy, and then you can return it to him — when he gets through testifying.

BY MR. BERKELEY:

Q. Mr. Dunn, you speak of that year as a year in which 92.98 per cent of the total consolidated tax income and tax liability were allocated to United Gas Pipe Line Company.

How do you account for that high percentage of an allocation to United Gas Pipe Line Company which in that year made refunds that wiped out all tax liability for all the constituent members of the tax return group and also resulted in a substantial carry-back to the year 1959? Don't you think that you should have reflected the rate refund in allocating tax to United Gas Pipe Line Company?

MR. FLETCHER: Now, counsel himself brought out a minute ago by his own questions that that figure was before refunds. I don't see any profit in the question.

MR. BERKELEY: I don't understand how —

PRESIDING EXAMINER: You may answer the last part of the question, the question part. Would you read that, please?

2894

(The question was read.)

THE WITNESS: In the first place, the refund didn't wipe out any tax liability. We paid our tax liability for the year or will pay it for the year 1962, with the fact that we paid too much money in prior years, and as shown on 14-6, the tax liability is $6,647,645.

Now, since that will be paid by foregoing a refund, and, in addition, we will have a carry-back to 1959, the net effect

is that we will get back the 13 — United Gas Pipe Line will get back the $13,443,083 that it was overcharged in years prior to 1962.

MR. BERKELEY: May I have that answer read back, Mr. Examiner? It was very difficult to follow.

PRESIDING EXAMINER: All right

(The answer was read.)

BY MR. BEKEELEY:

Q. You referred in your answer to a figure of tax liability of $6,645,000 in Exhibit 14-6. I can't find it there. Will you please refer me to the line and column?

A. I think the only figure I referred to was the 1962 estimated tax liability of $7,647,645. That liability is not wiped out, it is simply paid by foregoing a refund.

Q. But isn't it a fact that in the earlier years in which the tax was paid, the Internal Revenue people are not giving you any refund of tax paid in that year, are they?

2895

A. Would you read the question, please?

(The question was read.)

THE WITNESS: They are giving a refund of the 1959 overpayment, yes.

BY MR. BERKELEY:

Q. Only 1959, because of the carry-back of the loss from 1962, isn't that correct, Mr. Dunn?

A. Well; if you can carry it all back to 1959, that is where you carry it back to, three years back.

Q. But you use it first in the year in which the tax loss is realized, which is 1962, isn't that correct?

A. Well, you use it to pay the 1962 tax. There isn't any particular point in sending them a check for seven million-odd dollars and then having them send you the check back again.

Q. And it is also a fact that you won't receive any interest from the Bureau of Internal Revenue for the alleged overpayment that you say was made for taxes in 1956, '57, '58, '59, '60 and '61?

A. No, no interest.

Q. And then isn't it a fact that at least under the tax law, the transaction represents a reduction in taxes in the year 1962 for the first time?

A. There is no reduction in taxes in the year '62.

Q. It is a tax deduction which under the tax law becomes available for the first time in 1962.

2896

MR. FLETCHER: Oh, let's not argue that point again, Mr. Examiner.

PRESIDING EXAMINER: I will sustain the objection. It is strictly argumentative at this point.

BY MR. BERKELEY:

Q. You spoke in your answer also of the fact that the refund didn't wipe out any part of the tax liability that would otherwise be payable of $7,647,000 for the entire consolidated tax return group.

Isn't it true that the consolidated tax will be zero in 1962?

A. No, sir.

Q. Will United Gas Corporation and its subsidiaries viewed as a single consolidated tax return entity pay any tax in 1962, Mr. Dunn?

A. Certainly, they will pay it by foregoing a refund. If you owed me $50 and I owe you $50, I can pay you and you can pay me by us foregoing what we owe each other.

Q. Is it your understanding of the tax law, Mr. Dunn, that United Gas Corporation would have an option as to the tax treatment of this $35,454,000 item and take it as a refund in the earlier beginning '56 and ending '61?

A. Have an option to do what?

Q. Could United Gas Corporation forego a tax deduction in the amount of $35,454,000 in 1962 —

A. That is not a tax deduction. I can't answer that question. It is not a tax deduction. It is a refund, that is an overpayment of taxes — not a deduction.

Q. Isn't it claimed under Section 1341 of the Internal Revenue Code?

A. As I understand it, 1341 is the right to go back to the respective years. I don't think they are going to take this under 1341.

Q. What section will they take it under?

A. I would have to find that out from Mr. Barham.

Q. Would you supply that information?

A. Yes.

Q. Are you aware of any option the company may have under eht tax laws to reform its tax returns for earlier years with respect to these refunds?

A. All procedures under the tax laws involved certain risks, from penalties as well as options. As I understand it, there is a 1341 procedure prescribed, which if it does not serve any useful purpose there is no use going to that procedure.

Q. There was no tax benefit?

A. Oh, no.

Q. Are you prepared to state there is no benefit —

A. You have attempted to distort my testimony. I say if there is no difference in the result you get, there is no

2898

use going to that form.

• • • • •

3096

THE WITNESS: The tax return, the consolidated tax return

3097

will reflect elimination of intercompany dividends to the extent that they have been included in the return — in other words, the return will be prepared in such a way that there will be no tax on intercompany dividends.

(3097)

BY MR. BERKELEY:

Q. Is that also true of intercompany interest payments made by the pipeline to the Gas Corporation?

A. That is right, and, of course, the revenues from those intercompany interest payments will also be eliminated to the extent that there is no tax on revenues from intercompany interest, or payments of intercompany interest — it is washed out.

• • • • •

3252

• • • • •

Cross-Examination by Memphis Light, Gas and Water Division —

BY MR. SPIEGEL:

Q. I would like to refer you, Mr. Dunn, to transcript page 518 in which you state that the taxable income shown for certain years in Smith's Exhibit No. 23 do not in all cases reflect all the revenue agent report adjustments and Internal Revenue Service adjustments.

I would like you to turn to Exhibit 23, Schedule 6, and tell me what figures should be adjusted in the light of your statement.

A. To the extent that the figures for taxable income and consolidated tax in Exhibit 23 do not agree with the taxable net income per revenue agent's report shown in Exhibit 14-1, Schedule No. 3 and following schedules for the respective years, they do not reflect the adjustments made by the Internal Revenue Service.

Q. Well, I am trying to relate the figures which we have used — which were obtained from the company — to what may be revisions of tax returns or RAR reports subsequent to the time the figures were furnished us.

Now, in Exhibit 14-1, the comparable figure is not shown as such. In other words, you don't show in Exhibit 14-1 the net taxable income in consolidation for United Gas Pipe Line, as such. I believe that to be the case, sir.

A. That is correct. The taxable net income for the three

3253

separate companies is shown, and the consolidating adjustments are shown, but the total is not shown, nor do I have it readily available.

MR. SPIEGEL: Mr. Examiner, I would like to have marked for identification as an exhibit a one-page document entitled "United Gas Pipe Line Company, Docket No. RP63-1, Summary of Taxable Income in Consolidation, Years 1957 to 1961", about which I would ask some questions of this witness.

PRESIDING EXAMINER: All right, do you have copies there?

MR. SPIEGEL: I have copies.

PRESIDING EXAMINER: All right, the document just described will be marked Memphis Exhibit No. 36 for identification.

(THE DOCUMENT REFERRED TO WAS MARKED FOR IDENTIFICATION AS EXHIBIT NO. 36.)

• • • • •

3256

• • • • •

MR. SPIEGEL: The pending question is whether Mr. Dunn is in a position to accept these figures as being the taxable income as it applies to Exhibit No. 23, Schedule

No. 6, of United Gas Pipe Line, the ones to be substituted in his view for those shown on Schedule 6 of Exhibit 23.

THE WITNESS: Of course it is utterly impossible for me to check as to a figure which I don't have, except in this way.

It appears to me that what this schedule shows is that it was taken from Exhibit 14-1, from the respective schedules, and simply reverses certain adjustments that appear on those schedules under the column "Adjustments" on line 3 for the respective periods, to come to a consolidated total. Is that what you did?

BY MR. SPIEGEL:

Q. Yes, basically—

PRESIDING EXAMINER: Well, let's accept the figures subject to check as purporting to be what they are, subject to check, and I take it they are derived entirely from Mr. Dunn's exhibits.

MR. SPIEGEL: In an effort to speed up the cross examination, I was responding to Mr. Dunn that these figures are derived by eliminating the inter-corporate trans-

actions which are eliminated in developing a consolidated net taxable income, but they do not include your further adjustments which you described in your testimony for out-of-period and non-utility costs, and the like, as you express it.

THE WITNESS: In other words, these figures would put back into the taxable income Union Producing Com-

pany's oil tax deductions, and they would put back into the income for the respective years the amount of rate refunds that the Commission —

PRESIDING EXAMINER: Well, they put in Union's oil losses, as I see by these negative figures, is that correct? Is that what these negative figures are?

MR. SPIEGEL: Yes.

MR. FLETCHER: My only observation is, Mr. Examiner, with your suggestion that we accept it subject to check, I can accept the figure, but not as representative of the taxable income.

• • • • • •

3258

• • • • • •

MR. SPIEGEL: But when you go to his Exhibit 14-1, he does not show, as such — and he so testified — the taxable income in consolidation in its most final revised form as approved by Internal Revenue.

3259

• • • • • •

MR. SPIEGEL: Well, I am trying to find out from Mr. Dunn — the figures that we have in Mr. Smith's exhibit, Schedule 6, were provided to us by the company. I am now trying to find out from Mr. Dunn whether these are the appropriate figures to be substituted for Mr. Smith's appropriate figures, or whether something else should be

3260

substituted for it.

Now, I can go through figure by figure, if necessary.

PRESIDING EXAMINER: Can't we agree as to the accuracies of this summmary subject to check?

MR. FLETCHER: Mr. Examiner, I am willing to do what you first suggested — I am willing to agree for the purposes of the cross that this is a computation which can be checked, and he will accept the figures of the computation subject to check, but I wouldn't attempt to agree that there is any substantive merit or affirmative correctness in these figures, I don't know.

PRESIDING EXAMINER: Let's proceed on that basis, Mr. Spiegel, that will enable you to proceed with your cross examination.

• • • • •

3268

• • • • •

Q. Mr. Dunn, at transcript 2946, your counsel stipulated —

A. Do I need the transcript?

Q. I don't think so At transcript 2946, your counsel, Mr Fletcher, stipulated that Exhibit 14-6, column 2, contains the latest adjusted Federal income tax figures, and my question is can you give me the related Federal income tax figures for each of those years 1956 through '61 of the consolidated tax and of the tax as allocated to United Gas Corporation and Union Producing?

In other words, I would like to have the latest figures which are consistent with the figures that are in 14-6, column 2.

A. Now, you would like to have the figure for 1956 comparable to the $11,710,802 that was allocated to Gas Corporation and to Union Producing Company for that year?

Q. Yes, along with the total consolidated tax.

A. All right, this may already be in the record — maybe it is just the percentages I read in.

Q. I think the percentages are. We checked very carefully.

A. For the year '56, the total consolidated tax is $12,800,090. Allocated to United Gas Corporation, $1,089,288, and nothing to Union. In other words, if you add that figure I just gave you and the 11 million, you

3269

would come to the $12,800,000 figure, so I will read them in that fashion.

Q. You might as well read in United Gas Pipe Line at the same time so I will have the whole thing.

MR. FLETCHER: That is already in the record — I object to that.

BY MR. SPIEGEL:

Q. All right, don't bother.

A. Consolidated tax, this is 1957, $13,560,947. United Gas Corporation, $1,311,344. Nothing to Union.

For 1958 — that requires a little addition and subtraction in that year, because Union had a profit.

The total consolidated tax, $16,188,431. United Gas Corporation, $1,845,481 — no, change that. It is $2,188,676. Those two figures added together give the total.

BY MR. SPIEGEL:

Q. What is it for Union Producing?

A. Nothing, they had a tax, but that tax was reallocated which is why I had to do some mental adding.

For 1959, total consolidated tax, $11,373,269, United Gas Corporation, $1,400,049, and nothing for Union.

For 1960, the total consolidated tax, $8,265,382, United Gas Corporation $1,101,362, and nothing for Union.

For 1961, total, $7,998,911, nothing for Corporation or Union.

3280

• • • • •

Of course, in addition to that, if Union even thought that they were faced with a tax loss that was to be given away to some customers of United Gas Pipe Line Company on the grounds that Union couldn't use it, Union can easily and very readily sell a production payment, produce income and use its tax loss.

Furthermore, of course, Union being a producing company, its tax deductions are controllable. Union can control how many wells it drills in any year, and one of the main items of tax deduction is well drilling expense, both producing wells and non-producing wells, and in any given period of time Union can control to a very large extent how many wells it drills, so that there is no reason whatever to assume that Union Producing Company, being a highly successful production company and with large gas and oil reserves, proven oil reserves, would ever be in a position of not being able to utilize its tax deductions.

• • • • • •

3356

• • • • •

A. Well, certainly with respect to Union Producing Company's oil operations, those operations are in no way

3357

related to the activities of United, and under no theory are those operations chargeable to the customer, but rather are costs which come out of the pocket of the Gas Corporation stockholders, inasmuch as the stockholders of the Gas Corporation through Gas Corporation's ownership of the stock of Union are the ultimate stockholders that must bear any losses, profits or costs that give rise to tax deductions on Union.

• • • • •

3368

MR. SPIEGEL: He has said it generally. What I was trying to obtain in that question was what actual figures did he take from the tax return, what are the numbers? I am trying to validate and cross examine the cource of that figure.

PRESIDING EXAMINER: Mr. Dunn?

THE WITNESS: Well, you see how this is labelled depletion for tax purposes, when you go to the well-by-well basis you may find on certain wells that it is not percentage depletion for that particular year. That is, you may be limited to 50 per cent of net, or even in certain instances the figure might be a cost figure, because the 50 per cent of net was zero, so that in this depletion figure is a combination of the best advantage that the company can get

out of the tax return, namely whether it — most of it, of course, is percentage depletion, but there is a few instances where one well will be on a cost basis and another will be on a 50 per cent of net basis, and this is the total of the amounts that were actually claimed on either one of the three alternatives for the oil wells, on the one side, and the gas wells on the other.

In other words, we simply totalled the gas wells and totalled the oil wells to find out how much of the percentage depletion or tax deduction for depletion related to oil and how much related to gas, taken direct from the tax

3369

return.

PRESIDING EXAMINER: Do I understand that you took the total volumes of gas and oil and the revenues resulting from those volumes after you made your classification of the wells?

THE WITNESS: Well, actually the wells are set out on the tax return, itself, each time, and, of course, the wells are classified, so the tax return will show with respect to each individual well the amount claimed for percentage depletion and the production from the well, whether gas or oil, and the revenues received from such production — all the details are shown right on the schedule. The revenues, total revenues received are shown, and the computation for each respective well.

3370

BY MR. SPIEGEL:

Q. Well, will you give me the computation of the $5,185,647 figure shown for oil depletion for tax purposes

on Schedule No. 12 of Exhibit 14-1 beginning with whatever figures you took from the tax return direct?

A. These figures all come from the tax return direct.

Q. The $5,185,647?

A. They are the total of the oil wells, and the $7,917,361 is the total of the gas wells, from the tax return.

Q. Well, on what schedule does the figure $51,85,647 appear — on what schedule of the tax return?

A. Well, it is the details that make up the $5,185,657 that appear on the depletion schedule of the tax return. The tax return doesn't necessarily require that the taxpayer show that figure separately by simply making another schedule to add them up. However, the total is added up, and in order to find out how much related to oil and how much related to gas, it is a very feasible and direct method to add up the oil wells and add up the gas wells and find out what the direct tax deduction was for oil and what the direct tax deduction was for gas.

Q. Is that how you did it?

A. Yes, or had it done.

Q. Well, now, can you read off for me the breakdown of the numbers which you added together which appear on the

tax return which total $5,185,647?

A. Not from a summary — you don't burden the record with the detail of 1200 some wells.

Q. Are you saying there are 1200 separate figures for 1200 separate wells on the tax return, and you added those numbers together?

A. Except to the extent they might be combined on the tax return for leases, but there are a large volume of separate computations on the tax depletion schedule in the tax return.

Q. Is it a matter of simple addition of figures on the tax schedule?

A. Primarily, and understanding what you are adding.

Q. Does your use of the word "direct" in column 13, lines 22, 23 and 24 of Schedule No. 2 of Exhibit 14-1—Schedule 12—mean that you did not use any allocation prices in deriving the breakdown between oil and gas for tax depletion, confining that to line 23?

A. That is right. The basis of assignment, oil and gas, was the basis of the tax return direct charges.

Q. Can you give me the exact title of the schedule and the exact pages of the schedule of the Federal income tax return for 1961 in which there will be found the breakdown of this $5,185,647 figure?

A. No, I don't carry that sort of information around

in my head.

Q. Do you have it in your work papers with you?

A. No.

Q. Did you bring the tax return—is the tax return here?

MR. FLETCHER: It is not, and I advised you the first day it was not here, Mr. Spiegel.

MR. SPIEGEL: Mr. Examiner, I must at this time move to strike this exhibit on the grounds that it is unsupported by probative testimony which shows the way in which these figures which are alleged to come from the tax return have come from the tax return and been utilized in this case.

In other words, there is an absence of proof, and an inability on their part to explain on cross examination and justify the foundation of those figures.

MR. FLETCHER: Do you care to hear from me on that?

PRESIDING EXAMINER: Yes, Mr. Fletcher.

MR. FLETCHER: The motion of course is without any merit whatsoever. The exhibit is fully explained, the source of the figures is fully explained. Now, the real point of the motion is not a motion to strike the exhibit, but for some reason counsel wants to try to force the production of the tax return in this hearing room, a matter that is not at all necessary.

The exhibit is fully explained and the source of the

figures is explained and the figures are vouched for, and nothing has appeared which brings into question a single solitary figure in the exhibit. The evidence is fully sufficient, and the motion in my opinion is without any merit.

PRESIDING EXAMINER: I am going to deny the motion.

BY MR. SPIEGEL:

Q. Mr. Dunn, referring to Exhibit 14-1, Schedule 12, line 23, can you tell me of the total shown in column 9 of $13,103,008 how much of that depletion is applicable to condensate wells?

A. Oh, no, I did not attempt to break this down other than between gas wells and oil wells, or attempt to classify a gas well as again a condensate gas well or some other kind of a gas well, which classification I don't know even exists.

Q. Well, tell me where is the depletion which is referable to condensate liquids placed as between the column headed "Oil" and the column headed "Gas", columns 10 and 11?

A. Where did you ever hear of any depletion applicable to condensate liquids? Where did that figure ever come from? Out of the blue?

PRESIDING EXAMINER: Well, I take it there is no such classification in this exhibit.

THE WITNESS: No.

PRESIDING EXAMINER: All right.

3374

BY MR. SPIEGEL:

Q. Do your total revenues shown on line 1, column 1 of $52,891,396 include revenues for condensate liquids?

A. Revenues —

Q. Schedule 12, Exhibit 14-1.

A. Yes.

Q. Well, now, isn't it true that in 1961 there was depletion for tax purposes related to the revenues received from condensate liquids — isn't that true?

A. I would have to check on whether or not the condensate, which is something that is derived from the gas after it is produced from a well in the gas stream was or can be reflected in a percentage depletion computation. I don't recall seeing — from going through the tax returns — any computation for a figure representing revenues received from products obtained from the gas after production.

I can check as to just how that is handled in the tax returns for you. I don't recall at the moment.

Q. Will you be able to check over the lunch hour?

A. I can't give you numbers, but I can tell you how the percentage depletion is computed with respect to the gas produced from the gas wells.

Q. Well, do you know the breakdown of operating revenues or the amount included in operating revenues on Schedule No. 12, line 1, for condensate liquids?

3375

A. I believe that is shown in the excluded exhibits in this case, yes.

Q. Well, I am now referring to Schedule No. 12, line 1, column 1, and I am asking you how much of that, if you know, is liquid condensate?

A. Well, as I say, those figures were all set out in the detailed schedules on Union showing revenues, allocations, tax deductions, which are the excluded exhibits in this case,

and I do know that they are shown on there. I would have to look at the excluded exhibits and read from them to tell you the amounts.

Q. I just asked you for one amount. I am asking you how much the condensate liquid revenue is within $52,891,396 shown on line 1, column 1, if he knows.

MR. FLETCHER: I submit he has answered that.

BY MR. SPIEGEL:

Q. Do you know?

A. Well, not without referring to the exhibit that was excluded, which contains that information.

Q. I am not asking you where you go — I am asking do you know.

MR. FLETCHER: He just wants to use the excluded exhibit.

PRESIDING EXAMINER: He has answered the question that he knows, if he can refer to the exhibit.

MR. FLETCHER: That is right.

MR. SPIEGEL: I am asking him how much it is.

MR. FLETCHER: Do you want him to refer to the excluded exhibit?

PRESIDING EXAMINER: Do you want him to put this figure in the record?

MR. SPIEGEL: I would like this figure in the record. Maybe he has it in his workpapers.

PRESIDING EXAMINER: Is there objection?

MR. FLETCHER: Yes, I object to it unless he instructs the witness to use the excluded exhibit which the witness says is the source of the information.

PRESIDING EXAMINER: It seems to me that is obviously necessary for the witness to answer the question.

MR. FLETCHER: But when I ask him to be sure we didn't get in a hassle down the way about it, he evaded the question and did not answer it.

PRESIDING EXAMINER: Counsel, I don't want to get into an argument between counsel on this.

Mr. Dunn, can you obtain this figure —

MR. FLETCHER: It is agreeable to me, Mr. Examiner, it is notrouble to me. I am quite agreeable for him to refer to the exhibit and get the number.

PRESIDING EXAMINER: I understand that this is the purport of the question.

MR. SPIEGEL: Of course, I am not trying to bring

that exhibit in. Maybe I can ask a preliminary question.

BY MR. SPIEGEL:

Q. Is there any other place in your working papers that you are able to determine, without going to the exhibit, the total number of operating revenue dollars for condensate liquids for the year 1961 which is included within the figure of $52,891,396 — is there any place you can find it in your working papers, except by going to the excluded exhibits?

PRESIDING EXAMINER: We don't have to get into a hassle about the excluded exhibits. You have asked him a question about a figure. If the witness can get this figure, he can put it in the record, period.

MR. SPIEGEL: That is fine with me. I just don't want them throwing that exhibit in on me.

PRESIDING EXAMINER: We don't need to get in a discussion about that. If the witness can supply the figure, it can be put into the record. If he can't find it, it can't be put into the record.

Suppose we recess at this time.

(Whereupon, at 12:31 p.m., the hearing was recessed until 2:00 p.m., the same day.)

AFTERNOON SESSION

2:00 p.m.

PRESIDING EXAMINER: May we come to order, please. Whereupon,

E. L. DUNN

resumed the stand, and having been previously duly sworn, was examined and testified further as follows:

THE WITNESS: I believe you had asked me if I could give you a breakdown of the operating revenues between oil, gas and condensate.

Now, those operating revenues are from the financial statements of the books, and I have this much of a breakdown available.

For the year 1961, natural gas sales totaled $26,288,244. Gasoline and extracted production, $7,369,915.

Crude oil totaled $19,233,238.

The total of those three categories, $52,891,397, shown on line 1, Schedule 12 of Exhibit 14-1.

CROSS EXAMINATION (Resumed)

BY MR. SPIEGEL:

Q. Well, the question that I am asking is what is the revenue derived from condensate liquids in 1961?

A. The gasoline figure of $7,369,915 includes condensate sales and products extracted from condensate and from the gas stream which was not reduced to condensate. That is a combination figure of the liquids obtained from the

gas stream.

Q. Is the tax depletion applicable to that $7,369,915 of liquids included in your figure of $4,185,647 labeled "Oil," and Schedule 12 of Exhibit 14-1, line 23, column 10?

MR. FLETCHER: That is 5, not 4 — 5 million.

BY MR. SPIEGEL:

Q. $5,185,647.

A. No, whatever depletion is derived from the products obtained from the gas stream from gas wells is included as gas depletion.

Q. In other words, you have classified all condensate leases as gas leases in lines 22 through 24 of Schedule No. 12 of Exhibit 14-1 in the columns 6 through 13?

MR. FLETCHER: My objection to that, Mr. Examiner, is in the first place there is no such thing as a condensate lease, and, in the second place, the law is very well settled that what we call condensate and sometimes call also natural gasoline and other liquids extractable from gas are, by judicial decision gas.

PRESIDING EXAMINER: All right, I will sustain the objection as to the form insofar as it relates to the exhibit.

BY MR. SPIEGEL:

Q. Does the figure of $7,917,361 appearing on Schedule 12 of Exhibit 14-1, line 23, column 11, include all wells

classified as gas wells by state authorities even though they produce condensate as well as gas?

A. They include all the gas wells classified as gas wells by the respective state regulatory authorities, and those wells produce gas from which condensate is recovered after production, and those figures are all reflected in the $7,917,361 to which you refer.

Q. Now, does the figure of $5,185,647 appearing on line 23 of column 10 of the same schedule include all wells classified by state authorities as oil wells irrespective of whether they produce natural gas, in addition?

A. What do you mean by irrespective? They are classified as oil wells because they produce oil. Now, some of those wells produce some casinghead or solution gas which is something less than three per cent of the total gas sales, but that casinghead gas recovered from an oil well does not mean — does not make it a gas well irrespective of the

fact it produces oil — it is simply an oil well; and casinghead gas comes from an oil well.

Q. Do you know whether Union Producing has any multiple completion wells?

MR. FLETCHER: Now, is Union in or is Union out?

PRESIDING EXAMINER: I am going to sustain the objection.

MR. SPIEGEL: On what grounds, sir?

PRESIDING EXAMINER: On the ground it is irrelevant

and immaterial.

MR. SPIEGEL: No. The multiple completion wells he is allocating between oil and gas. A multiple completion well may produce both oil and gas and I am trying to find out how he has allocated it for purposes of this exhibit. I don't know what Mr. Fletcher is laughing about.

MR. FLETCHER: This is no allocation, Mr. Examiner.

MR. SPIEGEL: I am trying to find out — this is the purpose of cross examination, and I don't see how a chuckle from counsel table —

PRESIDING EXAMINER: Mr. Spiegel, my understanding is that the witness has explained exactly what he has done in this exhibit, and I have no objection to your cross examining him in as much detail as necessary to ascertain what he did, but when you start asking questions which are addressed to Union, we are getting into another area, and I don't want to open that door.

(3381)

Now, let's confine your examination to this exhibit.

MR. SPIEGEL: You are aware that this exhibit is Union Producing. The only figures on this exhibit are Union Producing figures.

PRESIDING EXAMINER: All the figures on this exhibit are from Union Producing?

MR. SPIEGEL: Yes, sir.

MR. FLETCHER: No, that is not so.

3382

MR. SPIEGEL: I am sorry, I mean this Schedule No. 12 is an allocation of costs between oil and gas, or deductions for Union Producing only.

PRESIDING EXAMINER: As I understand, the witness has said a number of times that he has taken the total volumes and sales attributable to oil and total volumes and sales attributable to gas to produce these figures based on the existing classification of the wells as oil or gas, isn't that correct?

MR. FLETCHER: Yes, sir, and in addition, Mr. Examiner, counsel overlooks the fact that this is a rebuttal exhibit. This is not Union's main case — it is a rebuttal exhibit, in rebuttal to his own exhibit on tax and to the staff's exhibit on tax.

MR. SPIEGEL: I might say I have a number of questions, but not very many, which are trying to find out exactly what was done in this portion of the exhibit.

PRESIDING EXAMINER: Well, as I indicated, you may go ahead on that line.

BY MR. SPIEGEL:

Q. On line 23, column 9, of the same schedule, you show intangible drilling costs —

MR. FLETCHER: Not line 23.

BY MR. SPIEGEL:

Q. I am sorry, line 24, column 9, intangible drilling

cost of $4,154,579, and my question is, is a portion of those drilling costs associated with multiple completion wells?

A. Not to my knowledge. I don't think Union has any what might be called multiple completion wells, but if they do, it would only be one or two

Q. Wasn't that something that you had to know in order to prepare the material shown on Schedules 12, 11, 10, 9 and 8 for the spreading of intangible drilling costs as between oil and gas?

A. They weren't spread, they were taken directly from the tax return and supporting papers, and they were from those wells classified as oil wells with those wells classified as gas wells.

PRESIDING EXAMINER: For my benefit, Mr. Dunn, would you tell me briefly what you mean by multiple completion wells?

THE WITNESS: In recent years, on very deep wells, there has been a technique developed to run various strings of tubing in the wells which permits one string of tubing to produce oil from one level and another string of tubing to produce gas from another horizon.

MR. FLETCHER: Or several different types of either.

THE WITNESS: And sometimes there have been as many as seven sources of production — some of these very deep wells go through as many as seven different producing

horizons, and this technique has been developed on the very, very deep wells.

MR. SPIEGEL: I believe there is a question outstanding, sir.

PRESIDING EXAMINER: I don't think so.

MR. SPIEGEL: Yes, I asked him a question about those completions, and then you asked him that question.

PRESIDING EXAMINER: No, he answered your question before I asked — do you want his answer read back?

MR. SPIEGEL: Yes, would you read the question and answer just before the Examiner's question?

(The question and answer were read.)

BY MR. SPIEGEL:

Q. It is my understanding, then, that you simply took the classifications as they appeared on the documents you mentioned, and did not analyze and go behind them, is that correct?

A. Well, they are classified on those documents according to state regulatory commission requirements, and, of course, I didn't go behind any state regulatory commission requirements.

Q. Now, included in the figure of $1,489,756 on line 24, column 10, are intangible drilling costs for wells which produce casinghead gas as well as oil, is that correct?

MR. FLETCHER: Now, Mr. Examiner, I am going to object to that. We have been through this, and he has told him

that casinghead gas came from an oil stratum.

PRESIDING EXAMINER: He has answered —

MR. SPIEGEL: No, I am asking him about intangible drilling costs. I have asked him some figures about depletion costs, and now I am asking the question about intangible drilling costs. We have not been over this.

I have a very short examination on this, but these are allocations which could be cross examined for weeks — I don't want to do that.

PRESIDING EXAMINER: I don't want to waste any more time, well, spend any more time than we have to.

You may answer the question, I take it to the extent casinghead gas is produced from oil wells, the answer would be the same.

THE WITNESS: It would.

MR. SPIEGEL: I can't make sense out of that. Let me ask my question.

PRESIDING EXAMINER: Go ahead with your question.

MR. SPIEGEL: I am not abusing the witness.

BY MR. SPIEGEL:

Q. I am asking you whether in connection with the intangible drilling cost shown on line 23, column 10, as $1,489,756 — I am asking you whether that includes intangible drilling costs for wells which are classified as oil wells but nonetheless produce casinghead gas?

PRESIDING EXAMINER: All right, he may answer.

THE WITNESS: The answer is yes, to the extent that any casinghead gas is produced by the oil wells in that column, the cost, intangible drilling cost is classified under oil.

MR. FLETCHER: Again, Mr. Examiner, the cases again hold that casinghead gas is oil.

MR. SPIEGEL: I must object to counsel making some kind of legal argument at this time.

MR. FLETCHER: I am not making a legal argument. You know that just as well as I know it and you are not surprised.

PRESIDING EXAMINER: Please, counsel, let's proceed with the interrogation.

BY MR. SPIEGEL:

Q. Focusing on line 23, column 11, the amount of $2,664,823 for intangible drilling costs for gas, will that include intangible drilling costs for wells classified as gas wells, but nonetheless producing condensate?

A. They produce gas from which condensate is extracted after production.

Q. Then you have not taken out of that figure any costs associated — any intangible drilling cost associated with condensate, is that correct?

A. I haven't taken anything out of that figure. It is

3387

the intangible drilling cost of gas wells, with nothing taken out.

Q. Are you aware of the fact that the state pro-ration classifications as between oil and gas are different in the different states in which Union Producing operates?

A. I, myself, am not particularly familiar with the state pro-ration laws in the respective states — state classification laws, rather.

• • • • •

3389

• • • • •

Q. Can you accept that figure subject to check?

A. Well, as I understand what you did, you took the combination of depletion from oil properties and depletion from gas properties, and a combination of depreciation from oil properties and depreciation from gas properties and the intangible drilling costs from oil properties and intangible drilling costs from gas properties, and added them together for each of the respective years, and then added the three items together to get a total.

Then you took the figure recorded as book depreciation and depletion for that year and each of the other years respectively, and deducted those figures from the tax depreciation and depletion and intangible drilling cost to arrive

(3389)

at the difference that you mentioned, namely $74,381,851, shown on the workpaper you gave me, and that figure is the arithmetical result of that process of computation.

I would like to say this, that depletion figures are directly related to the prices received for gas and oil

3390

respectively, and, of course, if any of the prices in those years are in any way changed, then we are faced with a depletion adjustment on the tax return with respect to that deduction.

Of course, I also don't want my agreement that the book depreciation and depletion figures are necessarily all of the costs of depreciation and depletion related to Union's properties on the basis of spreading the properties in proportion to the gas or oil produced and, incidentally, those book figures that you read were a combination of gas and oil properties, also.

• • • • •

3468

• • • • •

MR. BERKELEY: We will be glad to stipulate with you that the use of the consolidated tax technique will give to the benefit of United Gas Pipe Line customers, if you look at consolidated taxable income and actual consolidated tax, an effective tax rate lower than 52 per cent, and that this results from taking into account Union's losses on oil as well as Union's losses on gas.

MR. FLETCHER: Do I understand that the stipulation also includes that it was the intended purpose of the staff

to take those benefits and give them to the customers of United Gas Pipe Line Company?

MR. BERKELEY: It was that purpose, to the extent that it reflects the actual effective tax rate paid by the three companies that participate in the tax return, yes.

• • • • •

3671

Excerpt from testimony of Kenneth L. Smith, witness for Memphis Light, Gas and Water Division —

Direct Examination

PRESIDING EXAMINER: Well, I wish you would make your position clear. I might add, in making your position clear, I am interested in knowing whether in your view it is at all material or of any significance at all in the consolidated return as to how the losses or gains are produced, whether they are produced by a subsidiary being in the manufacturing of toys, or whether or not you are concerned at all as to what the effect of the process is, and, if so, to what extent is it material, significant, etc., etc.

3672

THE WITNESS: I do think that it is material, and I have given this matter a great deal of study over the last five or six years. In fact, I suspect it has pre-occupied my time, or more of my time than any other one object during that period of time.

The reason that I think it is material and relevant, and the reason that I think that the oil, the losses that might be assignable to oil or some other operation must be considered, goes back to the fact that we are attempting to regulate

here on a cost of service basis which includes a fair return on the investment, and we know that the costs that are actually incurred for the taxes of the consolidated group, and relating that to cost of service, of course we make a computation to try to reflect the taxes which would be incurred on the basis of a given rate of return allowance.

We know that by the very nature of things that that cost is a joint cost of the consolidated group. It has to be allocated. The very fact that United, as shown quite clearly in the record in this case, United Gas Corporation and its subsidiaries allocate that cost among themselves. That gets us to a cost basis for taxes, and we can quite readily express that cost basis when we use the effective tax rate which actually governs the amount of tax allocated to any one company such as United Gas Pipe Line in relation to its taxable income.

3673

Now, there is another facet to this that is very important and is very frequently overlooked, but I believe there is a great deal of support for considering it as a part of this one ball of wax.

When the Commission goes to the very vital problem, one of the most important in the rate case, of fixing the rate of return for United Gas Pipe Line, it looks at the rate of return that is required by United Gas Corporation as the vehicle through which much of the financing, if not all of it for the pipe line company and the whole operation is done, and it has to give recognition to the cost of capital in terms of contractual debt, and to the — in terms of the demands of investors in the equity securities which can only be measured through the holding corporation, the

top company, and therefore when the Commission decides a rate of return, the only standard that it has to go by is the standard provided by the vehicle of the financing of this group.

Now, I believe in Your Honor's question he referred to non-related, non-utility operations that might be a part of a consolidated tax return.

PRESIDING EXAMINER: Did I follow you so far, and correct me if I am wrong, that what you are saying in substance is that in the consolidated return you don't believe that a meaningful segregation of costs can be made? In other words,

3674

you don't really believe that a segregation of costs solely attributable to gas operations can be made?

THE WITNESS: With respect to the rate of return. I don't believe the Commission has ever been able to make it.

PRESIDING EXAMINER: Well, what about the situation of the non-related, non-utility operation, or subsidiaries?

THE WITNESS: Well, it is my belief that any operation that is included in the consolidated group has an effect on the — an ultimate effect on the rate of return for that group. It seems to me it is bound to.

PRESIDING EXAMINER: So that you would include a subsidiary that was manufacturing toys, let's say, so long as it participated in the consolidated return?

THE WITNESS: You mean for the purpose of —

PRESIDING EXAMINER: For the purpose of computing your effective rate, taking the tax losses of the toy

subsidiary in computing your effective rate for the regulated gas utility whose cost of service is the problem that is before the Commission.

THE WITNESS: If this was continuing, recurring tax loss which — and I could only — it poses a difficult question, because having a subsidiary of that kind and retaining it indefinitely by a holding company, by a utility system, a utility company group, poses a much different problem situation to me than having related oil operations, for example,

3675

which are not in a loss position so far as ordinary financial reporting is concerned — they are profitable operations, but they have a tax loss, and I am assuming that the rate of return fixed by the Commission and applied to the utility operation by the very nature of things is a composite of what the investor thinks of the enterprise as a whole, and if —

PRESIDING EXAMINER: And by the enterprise as a whole, do you mean all of the companies of the system, including all companies participating in the consolidated return regardless of the nature of the operation, whether regulated or not regulated by the Federal Power Commission?

THE WITNESS: Yes, and I am making one further assumption that the financing of these subsidiaries is through one vehicle, so that the financing of them, their going into the market for capital, can't be separated and is not in practical effect separated from that of the utility operation. I think that is one of the conditions that must be

present in my treatment here, and certainly it is present in this case.

Now, if there were a way, which the Commission I don't believe has been able to evolve — if there were a way in which the Commission could separate the rate of return for the utility business and put a rate of return on that business exclusive of all the other facets of a business that enter into the composite group, then I would give reconsideration to this matter of dividing up the tax cost

for the group, but I can't see any rational basis under which a regulatory commission could provide an incentive, and I believe it would be doing that if it did not recognize the impact of these tax losses on the composite picture, if they say "we will give you a tax allowance which disregards the fact that tax savings and tax reductions are provided through the tax losses of subsidiaries or related companies", and at the same time were unable to separate the cost of capital for the exclusive utility operation, what I think would be happening is that through the regulatory process the consumers of gas or electricity, or whatever it might be, would be validating the benefits of tax losses in such a way as to give — and by the benefit of a tax loss I simply mean there is a tax saving to somebody that has got to be accounted for or has to be somewhere in the scheme of things, as somebody is going to get the benefit of that tax saving, that is basic to this — that if validated that through the regulatory process by allowing taxes which would not be paid, it would in effect be allowing more than the fair rate of return which it was purporting to allow, and I believe it would be erroneous

• • • • •

INDEX

Volume II

Exhibit No.	Description of Document	Page In Joint Appendix	Page In Record
2–25	From UGPL Co. Ex. 2-25, Statement H(1) 4b—Account 922, Administrative expenses 12 months ending 3/31/62	2	(5242)
2–36	From UGPL Co. Ex. 2-36, Statement H(3)a, Federal Income Tax 12 Months ending 3/31/62, adjusted	3	(5264)
6–1	From UGPL Co. Ex. 6-1, Union Producing Company Statement of Income and Capital by Years, 1952 through 1961, (Schedule No. 1)	4	(5669)
14–1	From UGPL Co. Ex. 14-1, Summary of Taxable Income —years 1957 through 1961, inclusive, recited to reflect adjustments as indicated by detailed schedules (Schedules 1 through 13, inclusive)	5	(6209-6226)
14–6	From UGPL Co. Ex. 14-6, Summary of Tax Effects of 1962 Rate Refund applied to years in which affected revenues were received as compared with tax effect arising from rate income reduction in 1962	23	(6266)

Exhibit No.	Description of Document	Page In Joint Appendix	Page In Record
36 (Revised)	From Memphis Light, Gas and Water Division Ex. 36 (Revised), Summary of taxable income (or loss) in consolidation, United and Subsidiaries, Years 1957 through 1961, inclusive	24	(6524)
	FPC Order Providing for Hearing, Suspending Proposed Revised Tariff Sheets, and Fixing Date of Hearing, issued 7/27/62	25	(7116-7118)
	Excerpts from Presiding Examiner's Initial Decision issued 6/17/63: "Effective Tax Rate"	28	(8173-8176)
	Excerpts from FPC Op. 428 and Order Determining Rates and Providing for Refunds, issued 5/14/64	32	(9113-9166)
	From Majority Decision by Black, Commissioner	32	(9113-9150)
	Excerpt from Opinion of Commissioner Woodward concurring in part and dissenting in part	55	(9166)

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

UNITED GAS PIPE LINE COMPANY, *Petitioner,* v. FEDERAL POWER COMMISSION, *Respondent,* CITY OF MEMPHIS and MEMPHIS LIGHT, GAS AND WATER DIVISION, ET AL, *Intervenors.*	No. 21872
UNITED GAS PIPE LINE COMPANY, *Petitioner,* v. FEDERAL POWER COMMISSION, *Respondent,* CITY OF MEMPHIS and MEMPHIS LIGHT, GAS AND WATER DIVISION, ET AL, *Intervenors.*	No. 21958

JOINT APPENDIX

Volume II

Transcript of Exhibits and Decisions

(Joint Appendix Pages 1 to 55;

Record Pages 5242 to 9166)

5242 **Exhibit 2-25, United Gas Pipe Line Company Statement H(1)-4b-Account 922-Administrative Expenses 12 months ending 3/31/62 (Schedule H(1)-4b).**

Statement # 1
Schedule H(1)-4b

	Initials	Date
Prepared By		
Approved By		

United Gas Pipe Line Company
Account 922-Administrative Expenses Transferred-Credit

The activities of the Plant Accounting Department consist of general office accounting for Completed Construction Work in Progress, accounting for Plant in Service and retirements thereof, General Supervision of field accounting for Construction Work in Progress, recording in detail Current transactions affecting figures previously developed in connection with the ascertaining of the original cost of gas Plant and Other Properties, and Preparation of necessary Statements and Inventories relating thereto. The expenses of this department include the salaries, traveling and other expenses of the department head, his assistants, engineers, accountants and other departmental employees.

The expenses of this department which are applicable generally to the natural gas operations of United Gas Corporation, United Gas Pipe Line Company and to the Natural Gas and Crude Oil Operations of Union Producing Company are distributed to these Companies on the basis of a study of the time devoted to the accounting for such Companies, such time being segregated between accounting for Construction Work in Progress and accounting for Plant in Service. That portion of the time devoted to accounting for Construction Work in Progress is charged to Plant account and that portion of the time devoted to accounting for Plant in Service is charged to Operating Expenses.

Accounting for the expenses of the department was as follows:

Salaries		$ 250,119
Expenses of General Officers and Employees		239
Computer Expenses		708
Office Supplies and Expenses		2,560
1/ Maintenance of Office Furniture and Equipment		4,362
Total Gross Expense		$ 254,988
Less Amount Charged to Associated Companies:		
Union Producing Company	$ 80,975	
United Gas Corporation	8771	89,446
Amount Charged to United Gas Pipe Line Company		165,542
2/ Amount Credited to Acct. 922 Admin. Exp. Transferred-Credit		81,328
Balance of Admin. and Gen. Expenses		$ 84,014

1/ Maintenance Contracts on Office Machines
2/ Contra Account-Construction Work in Progress

United Gas Pipe Line Company Exhibit 2-36. Statement H(3)a, Federal Income Tax 12 months ending 3/31/62, adjusted.

STATEMENT NO(3)
SCHEDULE NO(3)-A

	Initials	Date
Prepared By		
Approved By		

UNITED GAS PIPE LINE COMPANY
FEDERAL INCOME TAXES
12 MONTHS ENDED MARCH 31, 1962 - ADJUSTED

LINE NO.	DESCRIPTION	(1)	(2)	(3) STATEMENT REFERENCE	(4) AMOUNT
1	RETURN ON RATE BASE AT 6.5%				25 197 877
2	OTHER INCOME				141 [illegible]
3	GROSS INCOME				25 [illegible]
4					
5	INCOME DEDUCTIONS				9 [illegible]
6					
7	NET INCOME				16 [illegible]
8					
9	OTHER INCOME AND NONDEDUCTIBLE DEDUCTIONS				
10	FEDERAL INCOME TAXES				12 099 662
11					
12	OTHER DEDUCTIONS AND NON-TAXABLE INCOME				
13	85% OF DIVIDENDS RECEIVED				27 [illegible]
14	TO ADJUST DEPRECIATION EXPENSE TO TAX BASIS				3 [illegible]
15	INTEREST DURING CONSTRUCTION				[illegible]
16	TO ADJUST BOND DISCOUNT AND EXPENSE TO TAX BASIS				7 695
17	LOSS ON ABANDONMENTS				89 117
18	DECREASE IN INVENTORY ADJUSTMENT RESERVE				47 179
19	EMPLOYEE BENEFITS CAPITALIZED				348 200
20	AMORTIZATION OF FRANCHISE				124
21	DEPLETION ALLOWANCE				816 21
22	CLEARING ACCOUNTS				47 627
23	TAXES CAPITALIZED				130 115
24	TOTAL OTHER DEDUCTIONS AND NON-TAXABLE INCOME				4 941 137
25					
26	NET TAXABLE INCOME				23 279 [illegible]
27					
28					
29	COMPUTATION OF FEDERAL INCOME TAXES				
30	52% OF NET TAXABLE INCOME				12 [illegible]
31	LESS SURTAX EXEMPTION				[illegible]
32	TOTAL FEDERAL INCOME TAXES				12 099 662
33					
34					
35					
36	NOTE: COMPANY DOES NOT CLAIM DEDUCTION				
37	FOR LIBERALIZED DEPRECIATION NOR				
38	ACCELERATED AMORTIZATION.				
39					
40					
41					
42					
43					

5669 : **United Gas Pipe Line Company Exhibit 6-1. Union Producing Company Statement of Income and Capital by years 1952 through 1961 (Schedule No. 1).**

UNION PRODUCING COMPANY

STATEMENT OF INCOME AND CAPITAL, BY YEARS
1952 THROUGH 1961

Line No.		(1) Total (10 Years)	(2) 1961	(3) 1960	(4) 1959	(5) 1958	(6) 1957	(7) 1956	(8) 1955	(9) 1954	(10) 1953	(11) 1952
	Operating Revenue											
1	Natural Gas	$ 219,358,305	$ 26,288,244	$ 26,215,423	$ 27,268,343	$ 27,044,934	$ 23,773,983	$ 23,122,375	$ 19,380,938	$ 16,427,407	$16,296,251	$13,540,407
2	Gasoline	84,249,519	7,369,915	8,033,152	8,782,503	9,425,928	9,424,478	8,494,738	8,179,487	7,977,362	8,750,039	7,811,917
3	Crude Oil	189,316,578	19,233,238	19,444,595	19,978,063	20,362,751	22,535,572	20,081,233	19,916,891	16,149,732	15,429,118	16,185,385
4	Total	492,924,402	52,891,397	53,693,170	56,028,909	56,833,613	55,734,033	51,698,346	47,477,316	40,554,501	40,475,408	37,537,709
	Revenue Deductions											
5	Operating Expenses	175,355,543	18,423,101	18,824,817	19,737,226	18,553,525	19,290,926	17,523,781	18,473,021	16,218,646	15,153,289	13,157,211
6	Depreciation and Depletion	60,000,000	7,900,000	7,400,000	6,600,000	6,700,000	6,400,000	6,300,000	5,500,000	4,500,000	4,500,000	4,200,000
7	Dry Holes	39,514,032	2,208,612	5,956,340	5,623,289	2,510,761	5,212,985	2,389,165	5,002,613	3,945,154	3,052,927	3,612,186
8	Unproven Leases Abandoned	24,019,193	4,297,734	2,985,850	2,648,666	2,619,532	2,994,938	1,931,005	2,422,655	1,656,327	1,308,001	1,154,485
9	Other Taxes	46,075,326	5,337,031	4,771,614	5,723,175	5,676,534	5,141,693	4,861,646	4,583,860	3,809,855	3,177,254	2,992,664
10	Federal Taxes	1,131,428	(280,815)	137,529	116,812	95,934	35,936	(272,281)	1,829	76,637	446,218	773,629
11	Total	346,095,522	37,885,663	40,076,150	40,449,168	36,156,286	39,076,478	32,733,316	35,983,978	30,206,619	27,637,689	25,890,175
12	Operating Income	146,828,880	15,005,734	13,617,020	15,579,741	20,677,327	16,657,555	18,965,030	11,493,338	10,347,882	12,837,719	11,647,534
13	Other Income	227,988	43,449	68,834	20,200	20,395	13,200	10,497	9,375	(9,036)	25,578	25,496
14	Gross Income	147,056,868	15,049,183	13,685,854	15,599,941	20,697,722	16,670,755	18,975,527	11,502,713	10,338,846	12,863,297	11,673,030
	Income Deductions.											
15	Interest on Debentures	20,400,000	2,040,000	2,040,000	2,040,000	2,040,000	2,040,000	2,040,000	2,040,000	2,040,000	2,040,000	2,040,000
16	Interest on Other Long-Term Debt	4,722,983	102,812	43,752	276,262	434,326	617,946	779,038	920,046	815,145	458,533	275,123
17	Other Interest	42,987	140	982	2,451	710	244	139	9,094	14	2,017	27,196
18	Interest Charged to Construction - Cr.	623,877	45,788	65,478	112,559	111,630	55,800	45,704	53,778	68,189	34,033	30,918
19	Other Deductions	1,093,396	98,316	96,657	117,821	84,391	209,988	82,930	63,238	189,713	82,314	68,028
20	Total	25,635,489	2,195,480	2,115,913	2,323,975	2,447,797	2,812,378	2,856,403	2,978,600	2,976,683	2,548,831	2,379,429
21	Net Income	121,421,379	12,853,703	11,569,941	13,275,966	18,249,925	13,858,377	16,119,124	8,524,113	7,362,163	10,314,466	9,293,601
22	Rate of "Return" Earned (line 12 ÷ by line 32)	10.92%	8.41%	8.17%	9.94%	13.70%	11.69%	14.15%	9.16%	9.53%	13.68%	13.40%
	Capitalization at End of Year											
23	Debentures	340,000,000	34,000,000	34,000,000	34,000,000	34,000,000	34,000,000	34,000,000	34,000,000	34,000,000	34,000,000	34,000,000
24	Advances from Affiliates	107,800,000	1,800,000			5,000,000	12,000,000	16,000,000	22,000,000	22,000,000	17,000,000	12,000,000
25	Misc'l Long-Term Debt	3,936,456	168,876	222,557	252,434	367,899	356,180	431,592	528,086	460,794	568,387	579,651
26	Total Debt	451,736,456	35,968,876	34,222,557	34,252,434	39,367,899	46,356,180	50,431,592	56,528,086	56,460,794	51,568,387	46,579,651
27	Common Stock	722,500,000	124,000,000	124,000,000	103,500,000	87,000,000	75,000,000	60,000,000	52,000,000	42,000,000	27,500,000	27,500,000
28	Capital Surplus	2,384,950	238,495	238,495	238,495	238,495	238,495	238,495	238,495	238,495	238,495	238,495
29	Earned Surplus	217,392,356	23,320,380	14,966,678	21,896,737	27,120,771	26,541,408	26,081,171	22,458,129	20,924,539	18,307,742	15,774,801
30	Total Equity	942,277,306	147,558,875	139,205,173	125,635,232	114,359,266	101,779,903	86,319,666	74,696,624	63,163,034	46,046,237	43,513,296
31	Total Capitalization	1,394,013,762	183,527,751	173,427,730	159,887,666	153,727,165	148,136,083	136,751,258	131,224,710	119,623,828	97,614,624	90,092,947
32	Average Capitalization	1,344,147,143	178,477,741	166,657,698	156,807,416	150,931,624	142,443,671	133,987,984	125,424,269	108,619,226	93,853,786	86,943,728
33	Dividends Paid	112,800,000	4,500,000	18,500,000	18,500,000	17,800,000	13,400,000	12,500,000	7,000,000	4,800,000	7,800,000	8,000,000
34	Sales of Common Stock	96,500,000		20,500,000	16,500,000	12,000,000	15,000,000	8,000,000	10,000,000	14,500,000		

( ) Indicates red figure

6209-6226 **United Gas Pipe Line Company Exhibit 14-1 — Summary of Taxable Income — Years 1957 through 1961, inclusive, recited to reflect adjustments as indicated by detailed schedules — Schedules 1 through 13, inclusive.**

Schedule No. 1

	Amount	Date
Prepared By		
Approved By		

United Gas Pipe Line Company

Summary of Actual Taxable Income Per Returns or Revenue Agents' Reports, as Adjusted, Allocated Consolidated Federal Income Tax and "Effective Tax Rates" - 1957-1961 Inclusive

Line No.	Years	(1)	(2) Taxable Income of U.G.P.L. Co.	(3) Consolidated Tax Allocated to U.G.P.L. Co.	Effective Rate (Ratio of Col (3) to Col (2))
1					
2	1957		$17477936	$8975774	48.210%
3					
4	1958		17778707	10781188	60.637%
5					
6	1959		16980187	8596179	50.625%
7					
8	1960		14167603	6691601	47.232%
9					
10	1961		20511046	10483406	51.111%
11					
12	6 Totals		$86914779	$44777266	51.519%
13					
14	7 5-Year Average		$17382936	$8955453	51.519%

D-21

6210

Schedule No. 2

	Initials	Date
Prepared By		
Approved By		

United Gas Corporation and Subsidiaries
Statement of 5 Year Average Taxable Income Realized to
Reflect Certain Adjustments as Indicated by Detailed Schedules

Year	Taxable Income Total	Taxable Income United Gas Corporation	Taxable Income to Consolidated United Gas Pipeline Co.	Taxable Income to Consolidated Union Producing Co.	United Gas Pipeline Co. Reduction Amt.
1957	$ 17,017,881.	$ 2,058,350.	$ 17,777,236.	$ (1,818,711.)	-
1958	24,815,376.	2,464,704.	17,778,767.	4,571,905.	-
1959	18,833,980.	2,915,169.	16,980,167.	(1,061,356.)	-
1960	21,685,304.	1,951,033.	21,167,503.	(1,433,232.)	-
1961	20,180,588.	(691,136.)	20,511,010.	360,648.	-
Total	$ 102,533,129.	$ 8,698,120.	$ 94,214,683.	$ (420,674.)	-
Average	$ 20,506,626.	$ 1,739,624.	$ 18,842,937.	$ (84,135.)	-
Separate Return Basis Tax @ 52% of Line 1d		$ 904,604.	$ 9,797,927.	$ 43,790.	-
Less: $ 25,000 Surtax Credit		25,000.	25,000.	25,000.	-
Tax Liability Separate Return Basis		$ 879,604.	$ 9,772,927.	$ 18,790.	-
Consolidated Tax @ 52% of Line 1d	$ 10,657,537.				
2% Additional Consolidated Tax	495,988.				
Less: $ 25,000 Surtax Credit	25,000.				
Total Consolidated Tax Liability	$ 10,653,125.				
Ratio of each Company's Separate Taxable Income to Aggregate of Consolidated Taxable Income of Companies Having Taxable Income	100.000%	10.424%	88.997%	.579%	
Allocation of Consolidated Tax (Above %) to Companies (Based on Line 2a)	$ 10,653,125.	$ 1,064,357.	$ 9,836,970.	$ 51,797.	

	Consolidated Tax	Separate Return Tax	Excess Separate Return Tax over Consolidated Tax
United Gas Corporation	$ 1,064,357.	$ 879,604.	
United Gas Pipe Line Co.	9,836,970.	9,772,927.	
Union Producing Co.	51,797.	18,790.	
Total	$ 10,953,125.	$ 10,671,321.	$ (281,804.)
Savings %			(.02657)

D-25

Schedule No. 3
Page 1 of 2

Prepared By		
Approved By		

United Gas Corporation and Subsidiaries
Computation of Consolidated and Separate Returns Basis Federal Income Tax, Adjusted
Year 1957

	Consolidated Totals	Eliminations Other	Eliminations Dividend Adjustment	Total Separate Returns Basis	United Gas Corporation	United Gas Pipe Line Company	Union Producing Company
Net Taxable Income (Per Books of Operating Report)					17,090,424.	25,708,093.	(2,779,999).
Adjustments:							
Unions Producing Company Depletion Less (Gain)							97,221.
Rate Refunds: Federal Power Commission					513,103.	(513,103.)	
To Customers					(513,103.)		
Taxable Income Per Books Operating Report Adjusted					17,090,424.	25,708,093.	(2,779,999).
Taxable Income:							
United Gas Corporation	$ 3,061,950.				17,090,424.		(14,028,474).
United Gas Pipe Line Company	17,777,724.		1,553,000.	19,330,724.		19,330,724.	
Unions Producing Company	(14,028,474).	(1) 16,970.	27,222.	17,570,222.		17,570,222.	
Total	6,811,200.	(2) 22,222.		(14,028,474).			(14,028,474).
Less: 85% of Dividends	97,222.	(3) 87,222.	1,637,610.	5,600,282.	17,090,424.	17,570,222.	(14,028,252).
Capital Gains				14,041,448.	14,013,948.	27,222.	22,222.
Capital Loss Carryover				182,282.	160,782.	21,500.	
Net Capital Gains				(160,782.)	(160,782.)		
				87,222.		65,000.	22,222.
Revised Taxable Income exclusive of Dividends and Capital Gains	19,047,581.			21,348,544.	5,339,321.	17,777,724.	(1,768,101).
Tax @ 52%	9,904,742.			11,099,243.	2,776,447.	9,243,916.	
Less: 1.5% Dividend Credit	57,000.			111,000.	56,000.	55,000.	
	9,847,742.			10,988,243.	2,720,447.	9,188,916.	
Capital Gains Tax @ 25% of Basis No.	-0-			11,249.	-0-	11,249.	
Total Tax	9,847,742.			10,999,494.	2,720,447.	9,200,165.	
Aggregate Consolidated Taxable Income of Companies having Taxable Income (Line 10, Rate Col. 4)	20,534,022.				30,561,350.	17,777,724.	
Percent of Item 2 of	100%.				63.08%	36.92%	
Total Consolidated Tax Allocated to Companies	9,847,742.				6,931,342.	2,916,400.	

(1) Capital Gains of United Gas Pipe Line Company Eliminated due to United Gas Corporation Capital Loss Carryover.
(2) Capital Gains of Unions Producing Company Eliminated due to United Gas Corporation Capital Loss Carryover
(3) For detail see page 2 attached
(4) Refund made in 1962 applicable to 1957 & Others

Schedule No. 3
Page 2 of 24

	Initial	Date
Prepared By		
Approved By		

United States Corporations and Subsidiaries
Computation of Consolidated and Separate Returns Basis
Federal Income Tax, Adjusted
Years 1957

	DIVIDENDS	(1) TOTAL Dividends Received	(2) Less Amount not out of Earnings & Profits	(3) Balance 100%	(4) 85%
1	United States Corporations				
2	United Gas Pipe Line Co.	56000000		56000000	47600000
3	Union Producing Co.	13900000	3446899	9531001	8101351
4	Total Intercompany	19000000	3446899	15553101	13220135
5					
6	Duval Sulphur & Potash Co.	933892		933892	793808
7					
8	Total Other	933892		933892	793808
9					
10	Total United Gas Corp.	19933892	3446899	16486992	14013943
11					
12	United Gas Pipe Line Company				
13	Southland Paper Mills, Inc.	3200000		3200000	2720000
14					
15	Total Dividends	19965892	3446899	16518992	14041943
16					
17					
18					
19					
20					
21					
22					
23					
24					
25					
26					
27					
28					
29					
30					
31					
32					
33					
34					
35					
36					
37					
38					
39					
40					
41					
42					
43					
44					
45					
46					
47					
48					
49					
50					
51					
52					
53					
54					
55					
56					
57					
58					
59					
60					
61					
62					
63					
64					
65					
66					
67					
68					
69					
70					
71					
72					
73					
74					
75					
76					
77					
78					
79					
80					
81					
82					
83					
84					
85					
86					
87					
88					
89					
90					
91					
92					
93					
94					
95					
96					
97					
98					
99					
100					

D-27

	Initials	Date
Prepared By		
Approved By		

United Gas Corporation and Subsidiaries
Computation of Consolidated and Separate Returns Basis
Federal Income Tax Adjusted
Year 1958

	Consolidated Totals	Eliminations Debits	Eliminations Credits	Separate Returns Basis Total Separate Returns	United Gas Corporation	United Gas Pipe Line Company	Houston Lighting Company
Net Taxable Income (See Separate Agents' Report)					18093674	22048181	4966503
Adjustments:							
Houston Lighting Company - Gain on Retirement of Debt (Note 1)							(1362123)
Rate Refunds: Missouri Public Service Commission					(241467)		
Federal Power Commission					503734	(478763)(2)	
Contra					(164388)		
Taxable Income per Income Agents Report Adjusted					18071753	17569418	3604380
Taxable Income:							
United Gas Corporation	3604704	9966030					
United Gas Pipe Line Company	17778207	1447792(1)	18071753	18071753	18071753		
Houston Lighting Company	3604380		17569418	17569418		17569418	
Total	24987291	(48007)(1)	27000	27000		27000	3604380
		2009672	3604380	3604380			3604380
Less: Net Operating Loss Carryback		3541972	15492251(3)	4063553	1907173	1756380	399000
Total After Net Operating Loss Carryback				3604380			3604380
Less: 85% of Dividends				3704173	1907173	1783380	399000
Capital Gains				1329201	1329201	27000	273000
Capital Loss Carryback				192678	192678	148007	44671
Net Capital Gain				(148007)	(148007)		(148007)
Earned Taxable Income Excluding Dividends and Capital Gains	2481326			148007		148007	
2% @ 52% of Line 20	1290370			2556766	577555	1779211	
2% Additional Corporate Surtax	48601			1274796	330000	944796	
Less: $5,000 Surtax Credit	5000						
Capital Gains Tax @ 25% of Line 21	1284671			16000	5000	11000	
Total Tax				1258796	325000	933796	
Aggregate Consolidated Taxable Income of Companies	1284671			37000		37000	
Housing Taxable Income (Item 13)				1221796	325000	896796	
Percent of Line 28	2481326						
	(100.000%)			3604704	1777207	2430165	
Total Consolidated Taxable Income Allocated to Companies (Based on Line 29)				100.000%	49.301%	67.402%	
Transfers of Houston Lighting Company's Taxable Income to Affiliated Companies (Based on Line 30)	1284671			100.000%	49.301%	67.402%	
Total Consolidated Taxable Income Per Companies				1284671	633000	865671	1784342
	1284671						(1784342)
				1284671	633000	865671	
				2548470	1078207	1470329	

(1) Capital gains of United Gas Pipe Line Company eliminated in consolidation by United Gas Corporation.

(2) Capital gains of Houston Lighting & Power Company eliminated in consolidation by United Gas Corporation.

(3) See detail schedule attached.

(4) Repeal rate refunds for 1958 applicable to 1957 revenues.

6214

Schedule No. 9
Page 1 of 2

	Initials	Date
Prepared by		
Approved by		

United Gas Corporation and Subsidiaries
Computation of Consolidated and Separate Return Basis
Federal Income Taxes Adjusted
Year 1958

	Dividends	(1) Total Dividends Received	(2) Less Amount not out of Earnings & Profits	(3) Balance 100%	(4) 85%
1	United Gas Corporation:				
2	United Gas Pipe Line Co.	-		-	
3	Union Producing Company	17800000000	332097507	14477902493	12307717119
4					
5	Total Intercompany	17800000000	332097507	14477902493	12307717119
6					
7	Uneval Sulphur & Potash Co.	1147535 62		1147535 62	975405 28
8	Atlas Processing Co.	1250000		1250000	1062500
9					
10	Total Other	1160035 62		1160035 62	986030 28
11					
12	Total United Gas Corp.	18960035 62	332097507	15639060 55	13293201 47
13	United Gas Pipe Line Company				
14	Southland Paper Mills, Inc.	3200000		3200000	2720000
15					
16	Total Dividends	18992035 62	332097507	15671060 55	13320401 47

D-29

	Initials	Date
Prepared By		
Approved By		

United Gas Corporation and Subsidiaries
Computation of Consolidated and Separate Return Basis
Federal Income Tax Adjustment
Year 1969

	Consolidated Totals	Eliminations Other Adjustments	Eliminations Dividends Adjustments	Total Separate Return Basis	Separate Return (Basis) United Gas Corporation	United Gas Pipe Line Company	Union Producing Company
Net Taxable Income (Per Revenue Agent's Report)					19880307	20977661	(1853746)
Adjustments:							
Union Producing Company - Net Operations Loss (Note)							1371880
Less Refunded: Municipal Public Service Commissions					(809518)		
Federal Power Commissions					599968	(396574)(2)	
To Customers					(324283)		
Taxable Income per Revenue Agent's Report Adjusted					19346474	20581087	(481866)
Taxable Income:							
United Gas Corporation	21315159	433852(1)	(2067767)	19364867	19364867		
United Gas Pipe Line Company	16980187		2077992	17262759		17081387	
Union Producing Company	(461866)			(461866)			(461866)
Total	18833480	433852	11633056(2)	29910848	19364867	17081387	(461866)
Less: 85% of Dividends	7368833			9514272	9514272	27200	
Capital Gains	173697			117540	44381	7048	16111
Revised Taxable Income Excluding Dividends and Capital Gains	11291450			20278197	9806214	16973139	(537477)
Tax @ 52% of Line 16	5871554			10805263	5099231	8824093	
Less: $600 Surtax Credit	55000			110000	55000	55000	
	5816554			10695263	5044231	8769093	
Capital Gains Tax @ 25% of Line 15	43424			29057	11095	17962	
Total Tax	5859978			10724320	5055326	8887055	
Aggregate Consolidated Taxable Income of Companies having taxable income (Line 19 plus Line 11)	19291346						
Percent of Line 23	100.00%						
Total Consolidated Tax - Allocated to Companies	5859978				21315159	16980187	
					11999%	88.001%	
					5055326	8887055	

Note:
(1) Exclusions from taxable income of debt retirement premium on redemption of United Gas Pipe Line Company bonds - applied in reduction of depreciable property bases.

(2) See detail on page 2 attached.

(3) Refunds made in 1967 applicable to 1969 disallowed

6216

Schedule No. 5
Page 2 of 2

	Initials	Date
Prepared By		
Approved By		

United Gas Corporation and Subsidiaries
Computation of Consolidated and Separate Returns Basis
Federal Income Tax, Adjusted
Year 1959

	Dividends	(1) Total Dividends Received	(2) Less Amount Not Out of Earnings & Profits	(3) Balance 100%	(4) 85%
1	United Gas Corporation				
2	United Gas Pipe Line Co.	-			
3	Union Producing Company	185000000	85561133 1	99438866 9	84523036 9
4					
5	Total Intercompany	185000000	85561133 1	99438866 9	84523036 9
6	Duval Sulphur & Potash Co.	12187500		12187500	10359375
7	Atlas Processing Co.	3062500		3062500	2603125
8					
9	Total Other	12493750 0		12493750 0	10619687 5
10					
11	Total United Gas Corp.	197493750 0	85561133 1	111932616 9	95142724 4
12					
13	United Gas Pipe Line Company				
14	Louisiana Paper Mills Inc	3200000		3200000	2720000
15					
16	Total Dividends	197813750 0	85561133 1	111225261 69	95414724 4
17					
18					
19					
20					
21					
22					
23					
24					
25					
26					
27					
28					
29					
30					
31					
32					
33					
34					
35					
36					
37					
38					
39					
40					
41					

D-31

6217

Schedule No. 6
Page 1 of 2

Prepared By | Date
Approved By | Date

United Gas Corporation and Subsidiaries
Computation of Consolidated and Separate Returns Basis
Federal Income Tax Adjusted
Year 1962

	Consolidated Totals	Eliminations Other Adjustments	Eliminations Dividend Adjustments	Total Separate Returns Basis	Separate Returns Basis United Gas Corporation	Separate Returns Basis United Gas Pipe Line Company	Separate Returns Basis Union Producing Company
Net Taxable Income (Per Return)					11,327,741.	17,592,629.	(4,239,624).
Adjustments:							
Union Producing Company - Oil Operations Loss (Note)							2,801,292.
Rate Refunds: Mississippi Public Service Commission					(82,108).		
Federal Power Commission					45,450.	(4,171,784) (2)	
To Customers					(371,708).		
Prepaid Gas Cost						71,895.	
Taxable Income Per Return, Adjusted					10,919,375.	13,492,732.	(1,438,332).
Taxable Income							
United Gas Corporation	11,951,043	631,668 (1)	1,056,513 (3) & 1,081,013	11,174,842.	11,174,842.		
United Gas Pipe Line Company	14,184,503		277,200	14,184,703.		14,184,703.	
Union Producing Company	(1,438,332)			(1,438,332).			(1,438,332).
Total	14,697,214.	631,668	9,414,726 (3)	23,921,213.	11,174,842.	14,184,703.	(1,438,332).
Less: 95% of Dividends				7,968,128.	7,940,928.	27,200.	
Capital Gains	600,356 (4)			151,326.	82,188.	-	69,138.
Received Taxable Income Excluding Dividends and Capital Gains	14,622,260.			15,833,819.	3,151,726.	14,157,503.	(1,498,270).
Tax @ 52% of Line 17	7,603,575.			9,014,786.	1,638,897.	7,363,102.	
Less: $5,500 Surtax Credit	5,500.			5,500.	5,500.	5,500.	
	7,598,080.			8,661,786.	1,633,397.	7,357,602.	
Capital Gains Tax @ 25% of Line 16	150,089.			177,177.	177,177.	-	
Total Tax	7,748,169.			9,014,936.	1,810,574.	7,357,602.	
Aggregate Consolidated Taxable Income of Companies Having Taxable Income (Line 16 plus Line 18)	16,118,536.			195,023.	14,167,503.		
Percent of Line 21	100.000%			12.047%	87.896%		
Total Consolidated Tax Allocated to Companies	7,748,169.			2,414,488.	1,809,601.		

(1) Exclusion from taxable income of debt retirement increase on retirement of United Gas Pipe Line Company bonds applied to reduction of depreciable property basis.

(2) For detail see page 2 attached.

(3) Request made on 1961 applicable to 1962 returns.

(4) Capital Gains Separate Returns basis (Note 16)
USG&E Co. Capital loss - deductible as ordinary income in Separate Returns but offset against Capital gains in Consolidated returns
Sub-total
Capital Gains eliminated in Consolidations (Note 16 - See Next Page)
Capital Gains taxable in Consolidations

	131,312
	2,003
	133,315
	69,168
	600,356

D-32

Schedule No. 6
Page 2 of 2

	Initials	Date
Prepared By		
Approved By		

United Gas Corporation and Subsidiaries
Computation of Consolidated and Separate Return Basis
Federal Income Tax, Adjusted
Years 1966

	Dividends	(1) Total Dividends Received	(2) Less Amount not due if Earnings Forfeit	(3) Balance 100%	(4) 85%
	United Gas Corporation				
	United Gas Pipeline Co.	-			
	Union Producing Co.	185000000	10408981 85	80910181 5	68773654 3
	Total Intercompany	185000000	10408981 85	80910181 5	68773654 3
	Duval Sulphur & Potash	1218750 00		1218750 00	1035937 50
	Atlas Processing Co.	3250000		3250000	2762500
	Total Other	1251250 00		1251250 00	1063562 50
	Total United Gas Corp.	1925125000	10408981 85	93426815	79409279 3
	United Gas Pipe Line Company				
	Smithland Paper Mills, Inc.	32000 00		32000 00	27200 00
	Total Dividends	1957325000	10408981 85	93742815	79681279 3

D-33

6219
Schedule No. 7.
Page 1 of 2

United Gas Corporation and Subsidiaries
Computation of Consolidated and Separate Returns Basis
Federal Income Tax Adjusted
Year 1961

	Consolidated Totals	Eliminations Affiliate Adjustments	Eliminations Dividend Adjustments	Total Separate Return Basis	United Gas Corporation	United Gas Pipe Line Company	Union Producing Company	United Gas Production Corporation
Net Taxable Income (Per Return)								
Adjustments:								
Union Producing Company (Oil Operations Only)								
United Gas Production Corporation								
Rate Refunds: Mississippi Public Service Commission								
Interest on Mississippi Public Service Commission Refund								
Federal Power Commission								
To Customers								
Prepaid Gas Cost								
Taxable Income Per Returns, Adjusted								
Taxable Income:								
United Gas Corporation								
United Gas Pipe Line Company								
Union Producing Company								
United Gas Production Corporation								
Total								
Less: Net Operating Loss Carryover								
Total after Net Operating Loss Carryover								
Less: 85% Dividends								
Capital Gains								
Revised Taxable Income Excluding Dividends and Capital Gains								
Tax @ 52% of Line 22								
7% Additional Corporate Income Tax								
Less: 85% Gross Income Credit								
Capital Gains Tax @ 25% of Line 21								
Total Tax								
Aggregate Consolidated Tax Allocable to Companies								
Having Taxable Income (Deficit Taxable Income)								
Percent of Line 30								
Total Consolidated Tax Allocable to Companies								
Transfer of Union Producing Company Net Deficit Carryover								
Total Consolidated Tax Payable								

Note:

(1) Payment of Mississippi Public Service Commission refunds previously collected under bond applicable to taxes as follows:

1958	$ 72,000
1959	88,000
1960	28,000
Total	$188,000

(2) Prepaid Gas Revenue:
Gross Revenue
Less 22½% Depletion
Net

(3) Dividends from Taxable Income of Affiliates not Consolidated

(4) Tax [illegible] per page 2 attached

(5) Represents Federal Income Tax applicable to rate refunds

(6) Capital gain changed to ordinary income. Property sold for fixed purposes only

(7) Tax rate is not applicable

Schedule No 7
Page 7 of

United States Corporation and Subsidiaries
Computation of Consolidated and Separate Returns Basis
Federal Income Tax, Adjusted
Years 1961

	Dividends	(1) Total Dividends Received	(2) Less Amount not Part of Taxable Income	(3) Balance 100%	(4) 85%
1	United States Corporation				
2	United States Pipe Line Co.	14 000 000 00		14 000 000 00	11 900 000 00
3	Union Producing Co.	4 500 000 00		4 500 000 00	3 825 000 00
4					
5	Total Intercompany	18 500 000 00		18 500 000 00	15 725 000 00
6	Duval Sulphur & Potash Co.	12 187 500 00		12 187 500 00	10 359 375 00
7	Atlas Processing Co.	3 250 000		3 250 000	2 762 500
8					
9	Total Others	12 512 500 00		12 512 500 00	10 635 625 00
10					
11	Total United States Corp.	19 751 250 00		19 751 250 00	16 788 562 50
12					
13	United States Pipe Line Company				
14	Smithland Paper Mills, Inc.	32 000 00		32 000 00	27 200 00
15					
16	Total Dividends	19 783 250 00		19 783 250 00	16 815 762 50
17					
18					
19					
20					
21					
22					
23					
24					
25	Note (7) Page 1 of Schedule No 7				
26					
27	Capital gains Separate Return Basis (Line 21)				171 614
28	Warren Producing Company - Capital gains Eliminated on Separate				
29	Return Basis by Net Operating Loss Carryover				140 094
30	Subtotal				311 708
31	Less: Capital gains eliminated in Consolidation (Line 17				
32	See Note (2))				76 917
33	Capital Gains taxable in Consolidation				234 791
34					
35					
36					
37					
38					
39					
40					
41					
42					
43					

D-31

6224

Schedule No. 2

	Initials	Date
Prepared By		
Approved By		

UNITED GAS PIPE LINE COMPANY

INCOME AND DEDUCTIONS OF UNION PRODUCING COMPANY

APPLIED IN DETERMINATION OF TAXABLE INCOME AS SHOWN IN CONSOLIDATED FEDERAL INCOME TAX RETURN

SHOWING AMOUNTS ATTRIBUTABLE TO OIL AND TO GAS

1957

	Total Per Books	Oil	Gas	Basis of Assignment to Oil and to Gas
Operating Revenues	$ 55734032.88	22355571.84	33378461.12	Direct - Per Books
Operating Expenses	19190926.05	7463152.94	11727773.11	" " "
Depreciation and Depletion	6400000.00	—	—	Not used for tax purposes
Dry Holes	5212985.81	1963732.57	3249253.24	(A) Oil 37.67% Gas 62.33%
Unproven Leases - Abandoned	2894938.13	1128193.21	1766744.92	(B) Oil 37.67% Gas 62.33%
Taxes - Per Books	5177627.90	1971134.46	3206492.48	Direct - Per Books
Total Operating Revenue Deductions	39 876 524.87	14 526 253.18	25 350 271.69	" " "
Net Operating Revenue	16 857 508.01	7 829 318.66	9 028 189.43	" " "
Revenue from Lse. Other Phys. Prop.	208975.	82187.	126788.	(C) Oil 40.91% Gas 59.09%
Interest Revenues	190714.	78052.	112662.	(C) Oil 40.91% Gas 59.09%
Misl. Non-Operating Revenues	208097.	85091.	122906.	(C) Oil 40.91% Gas 59.09%
Non-Operating Revenue Deductions	676989.	(41535).	(635454).	(K) Oil 30.36% Gas 69.64%
Total Other Income	430202.	175815.	254387.	
Gross Income	17 287 710.01	8 005 133.66	9 282 576.43	
Interest Expense	2658190.	979011.	1679179.	(D) Oil 36.83% Gas 63.17%
Interest During Construction (Cr.)	(55799)	—	—	Not used for tax purposes
Miscellaneous Income Deductions	209787.	79761.	130026.	(E) Oil 38.02% Gas 61.98%
Total Income Deductions	2812178.	1058772.	1753406.	
Net Income Per Books	$ 14475532.			
Totals - Forwarded		$ 8890897.	$ 11311679.	

	Total	Oil	Gas	Basis of Assignment to Oil and to Gas
Forward		$ 8890897.	$ 11311679.	
TAX ADJUSTMENTS - PLUS				
Exc. of Pen. Explor. Exp. Over Allow.	121829.	45893.	75936.	(A) Oil 37.67% Gas 62.33%
Exc. of Lse. Aband'ts Over Allow.	5124536.	1930312.	3194224.	(B) " " "
Exc. of Dry Hole Costs Over Allow.	114518.	43139.	71379.	(B) " " "
Contributions Inallowable	209763.	209763.	—	
Depr. Charged Clearing Accts. on Bks.	233805.	70749.	163056.	(C) Oil 30.262 Gas 69.738
Net Adj. of Clearing Accts. - Per Bks.	154.	47	107	(C) " " "
Misel. Adjs. Various Exp. Unallowable	—	—	—	
Misel. Income Adjustments	408967.	167308.	241659.	(C) Oil 40.91% Gas 59.09%
Misel. Tax Ded. Adjs. - Net	(88802).	(33807).	(54995).	(E) Oil 38.07% Gas 61.93%
Gain on Property Sales - Net	—			
- - - - - - -	22222.	—	22222.	TAX RETURN - DIRECT
Sub-Total		696123.	859757.	
TAX ADJUSTMENTS - MINUS				
Depreciation for Tax Purposes	3157919.	1534710.	1623209.	Tax Return - Direct
Depletion for Tax Purposes	12633348.	5148846.	7483908.	" " "
Intangible Drilling Costs	5956149.	2693436.	3262713.	" " "
Amort. Past Serv. Pension Payments	22	11	11	(A) Oil 49.72% Gas 50.28%
Production Payments Adjustment	791208	323683	467525	(B) Oil 40.91% Gas 59.09%
Amort. Road Expense Adjustments	1875	778	1097	(D) Oil 36.83% Gas 63.17%
Delay Rentals - Capitalized on Bks.	1221246	460043	761203	(A) Oil 37.67% Gas 62.33%
Straight Line Amort.	20362	—	20362	TAX RETURN - DIRECT
Sub-Total		$ 10161021	$ 13614278	
Total		(7400)	(1463989)	
Taxable Income per Ret. (See P.S.C.)		(2037990)		
Oil		(7400)		
Gas		(1463989)		
Total		(2037990)		

Note: See Schedule 16 & 13 attached for derivation of percentages used for assignment to Oil and Gas

D-36

6222

Schedule No. 9

Prepared By		
Approved By		

UNITED GAS PIPE LINE COMPANY

INCOME AND DEDUCTIONS OF UNION PRODUCING COMPANY

APPLIED IN DETERMINATION OF TAXABLE INCOME AS SHOWN IN CONSOLIDATED FEDERAL INCOME TAX RETURN,

SHOWING AMOUNTS ATTRIBUTABLE TO OIL AND TO GAS

1952

		Total Per Books	Total Oil	Total Gas	Basis of Assignment to Oil and to Gas
1	Operating Revenues	$ [illegible]	[illegible]	[illegible]	Direct - Per Books
2					
3	Operating Expenses	[illegible]	[illegible]	[illegible]	" " "
4	Depreciation and Depletion	[illegible]	[illegible]	[illegible]	
5	Dry Holes	[illegible]	[illegible]	[illegible]	Not used for tax purposes
6	Unproven Leases - Abandoned	[illegible]	[illegible]	[illegible]	
7	Taxes	[illegible]	[illegible]	[illegible]	Direct - Per Books
8					
9	Total Operating Revenue Deductions	[illegible]	[illegible]	[illegible]	" " "
10					
11	Net Operating Revenue	[illegible]	[illegible]	[illegible]	" " "
12					
13	Revenue from Lse.-Other Phys. Prop.	[illegible]	[illegible]	[illegible]	
14					
15	Interest Revenues	[illegible]	[illegible]	[illegible]	
16					
17	Misc. Non-Operating Revenues	[illegible]	[illegible]	[illegible]	
18					
19	Non-Operating Revenue Deductions	[illegible]	[illegible]	[illegible]	
20					
21	Total Other Income	[illegible]	[illegible]	[illegible]	
22	Gross Income	[illegible]	[illegible]	[illegible]	
23					
24	Interest Expense	[illegible]	[illegible]	[illegible]	
25	Interest During Construction (Cr.)	[illegible]	—	—	Not used for tax purposes
26					
27	Miscellaneous Income Deductions	[illegible]	[illegible]	[illegible]	
28					
29	Total Income Deductions	[illegible]	[illegible]	[illegible]	
30					
31	Net Income Per Books	[illegible]			
32					
33	Totals - Forwarded		[illegible]	[illegible]	

		Total	Oil	Gas	Basis of Assignment to Oil and to Gas
	Forward		[illegible]	[illegible]	
	TAX ADJUSTMENTS - PLUS				
	Exc. of Pen Explor. Exp. Over Allow.	[illegible]	[illegible]	[illegible]	[illegible]
	Exc. of Lse. Aband'ts Over Allow.	[illegible]	[illegible]	[illegible]	(A) " " "
	Exc. of Dry Hole Costs Over Allow.	[illegible]	[illegible]	[illegible]	(A) " " "
	Contributions Unallowable	—			
	Depr. Charged Clearing Accts. on Rts.	[illegible]	[illegible]	[illegible]	[illegible]
	Net Adj. of Clearing Accts.-Per Rts.	[illegible]	[illegible]	[illegible]	[illegible]
	Misc. Adjs. Various Exp. Unallowable	[illegible]	[illegible]	[illegible]	[illegible]
	Misc. Income Adjustments	[illegible]	[illegible]	[illegible]	[illegible]
	Misc. Tax Exp. Adjs. - Net	[illegible]	[illegible]	[illegible]	[illegible]
	Gain on Property Sales:				
	Sale	[illegible]	[illegible]	—	Tax Return - Direct
	Sale	[illegible]	—	[illegible]	Tax Return - Direct
	R.A.R. Adjust.	[illegible]	[illegible]	[illegible]	Tax Return - Direct
	Misc. — R.A.R. Adjust.	[illegible]	[illegible]	[illegible]	(C) Oil 24.4% Gas 75.6%
	Sub-Total		[illegible]	[illegible]	
	TAX ADJUSTMENTS - MINUS				
	Depreciation for Tax Purposes	[illegible]	[illegible]	[illegible]	Tax Return - Direct
	Depletion for Tax Purposes	[illegible]	[illegible]	[illegible]	" " "
	Intangible Drilling Costs	[illegible]	[illegible]	[illegible]	" " "
	Amort. Past Serv. Pension Payments	[illegible]	[illegible]	[illegible]	[illegible]
	Production Payments Adjustment	[illegible]	[illegible]	[illegible]	[illegible]
	Amort. Bond Expense Adjustments	[illegible]	[illegible]	[illegible]	[illegible]
	Delay Rentals - Capitalized or Rts.	[illegible]	[illegible]	[illegible]	[illegible]
	[illegible]	[illegible]	[illegible]	[illegible]	TAX RETURN - DIRECT
	Sub-Total		[illegible]	[illegible]	
	Total		[illegible]	[illegible]	
	Taxable Income per Net (per Sch. 2)	[illegible]	[illegible]	[illegible]	
	Oil		[illegible]		
	Gas			[illegible]	
	Total	[illegible]			

Note. See Schedule No. 13 attached for calculations of percentages used for assignment to Oil and Gas

D-17

Schedule No. 10

UNITED GAS PIPE LINE COMPANY

INCOME AND DEDUCTIONS OF UNION PRODUCING COMPANY

ALLOWED IN DETERMINATION OF TAXABLE INCOME AS SHOWN IN CONSOLIDATED FEDERAL INCOME TAX RETURN

SHOWING AMOUNTS ATTRIBUTABLE TO OIL AND TO GAS

For 1948

	Total Per Books	Total Oil	Total Gas	Basis of Assignment to Oil and to Gas
Operating Revenues	[illegible]	[illegible]	[illegible]	Direct - Per Books
Operating Expenses	[illegible]	[illegible]	[illegible]	" " "
Depreciation and Depletion	[illegible]	—	—	Not used for tax purposes
Dry Holes	[illegible]	[illegible]	[illegible]	(2) [illegible]
Unproven Leases - Abandoned	[illegible]	[illegible]	[illegible]	(3) [illegible]
Taxes	[illegible]	[illegible]	[illegible]	Direct - Per Books
Total Operating Revenue Deductions	[illegible]	[illegible]	[illegible]	" " "
Net Operating Revenue	[illegible]	[illegible]	[illegible]	" " "
Revenue from Lse.-Other Phys. Prop.	[illegible]	[illegible]	[illegible]	(4) [illegible]
Interest Revenues	[illegible]	[illegible]	[illegible]	(5) [illegible]
Misl. Non-Operating Revenues	[illegible]	[illegible]	[illegible]	(6) [illegible]
Non-Operating Revenue Deductions	[illegible]	[illegible]	[illegible]	(7) [illegible]
Total Other Income	[illegible]	[illegible]	[illegible]	
Gross Income	[illegible]	[illegible]	[illegible]	
Interest Expense	[illegible]	[illegible]	[illegible]	(8) [illegible]
Interest During Construction (Cr.)	[illegible]	—	—	Not used for tax purposes
Miscellaneous Income Deductions	[illegible]	[illegible]	[illegible]	(9) [illegible]
Total Income Deductions	[illegible]	[illegible]	[illegible]	
Net Income Per Books	[illegible]			
Totals - Forwarded		[illegible]	[illegible]	

Note: See Schedule No. 13 attached for derivation of percentages used for assignment to Oil and Gas.

	Total	Oil	Gas	Basis of Assignment to Oil and to Gas
Forward		6756617	13007389	
TAX ADJUSTMENTS - PLUS				
Exc. of Bad Debts Exp. Over Allow.	886421	220019	551537	(1) Col. 37.23% Line 42.77%
Exc. of Lse. Aband'ts Over Allow.	603343	171152	213041	(A)
Exc. of Dry Hole Costs Over Allow.	823202	110878	702414	(A)
Contributions Unallowable	117652	11741		
Depr. Charged Clearing Accts. on Rtn.	253701	72736	180965	(2) Col. 28.67% Line 71.33%
Net M.I. or Clearing Accts.-Per Rtn.	63145	15728	47417	(3) Col. 24.9% Line 75.1%
Misel. Adjs. Various Exp. Unallowable	—			
Misel. Income Adjustments	174776	45714	78714	(4) Col. 26.16% Line 73.84%
Misel. Tax Exp. Adjs. - Net	24453	7987	11511	(5) Col. 32.66% Line 67.34%
Gain on Property Sales - Misc.	624469		624469	Per Return - Misc.
Dollar	21524	7874	13650	(6) Col. 36.58% Line 63.42%
Office Supplies & Expenses - Misc.	17422	5022	12400	(7) Col. 28.82% Line 71.18%
Sub-Total		941434	1534734	
TAX ADJUSTMENTS - MINUS				
Depreciation for Tax Purposes	3667402	1495471	2173931	Tax Return - Direct
Depletion for Tax Purposes	13145969	5125254	8020715	" " "
Intangible Drilling Costs	5729673	1902883	3826790	" " "
Accrd. Past Serv. Pension Payments	—			
Production Payments Adjustment	836318	195085	230788	(8) Col. 46.3% Line 53.7%
Accrd. Bond Expense Adjustments	1605	711	894	(9) Col. 44.3% Line 55.7%
Delay Rentals - Capitalized on Rtn.	1700952	411823	1289129	(10) Col. 31.23% Line 68.77%
Intangibles Returned Direct	42521		42521	TAX RETURN - DIRECT
Sub-Total		9074732	14999484	
		(1371980)	(461326)	
Taxable Income per Ret. for Rate		(1371980)		
Oil		(461326)		
Gas		(1833306)		
Total				

6229

Schedule No. 11

UNITED GAS PIPE LINE COMPANY

INCOME AND DEDUCTIONS OF UNION PRODUCING COMPANY

APPLIED IN DETERMINATION OF TAXABLE INCOME AS SHOWN IN CONSOLIDATED FEDERAL INCOME TAX RETURN

SHOWING AMOUNTS ATTRIBUTABLE TO OIL AND TO GAS

1940

	Total Per Books	Total Oil	Total Gas	Basis of Assignment to Oil and to Gas
Operating Revenues	[illegible]	[illegible]	[illegible]	Direct - Per Books
Operating Expenses	[illegible]	[illegible]	[illegible]	" " "
Depreciation and Depletion	[illegible]	[illegible]	[illegible]	Not used for tax purposes
Dry Holes	[illegible]	[illegible]	[illegible]	(B) Oil 39.42% Gas 60.58%
Improven Leases - Abandoned	[illegible]	[illegible]	[illegible]	(B) Oil 39.42% Gas 60.58%
Taxes	[illegible]	[illegible]	[illegible]	Direct - Per Books
Total Operating Revenue Deductions	[illegible]	[illegible]	[illegible]	" " "
Net Operating Revenue	[illegible]	[illegible]	[illegible]	" " "
Revenue from Lse.-Other Phys. Prop.	[illegible]	[illegible]	[illegible]	(B) Oil 37.67% Gas 62.33%
Interest Revenues	[illegible]	[illegible]	[illegible]	(B) Oil 37.67% Gas 62.33%
Misc. Non-Operating Revenues	[illegible]	[illegible]	[illegible]	(B) Oil 37.67% Gas 62.33%
Non-Operating Revenue Deductions	[illegible]	[illegible]	[illegible]	(C) Oil 27.03% Gas 72.97%
Total Other Income	[illegible]	[illegible]	[illegible]	
Gross Income	[illegible]	[illegible]	[illegible]	
Interest Expense	[illegible]	[illegible]	[illegible]	(D) Oil 37.57% Gas 62.43%
Interest During Constpuction (Cr.)	[illegible]	[illegible]	[illegible]	Not used for tax purposes
Miscellaneous Income Deductions	[illegible]	[illegible]	[illegible]	Contributing Oil 27.03% Gas 72.97%
Total Income Deductions	[illegible]	[illegible]	[illegible]	
Net Income Per Books	[illegible]			
Totals - Forwarded		[illegible]	[illegible]	

Note: See Schedule No. 12 attached for derivation of percentages used for assignment to Oil and Gas.

	Total	Oil	Gas	Basis of Assignment to Oil and to Gas
Forward		[illegible]	[illegible]	
TAX ADJUSTMENTS - PLUS				
Exc. of Gen. Depler. Exp. Over Allow.	(1185996.)	(711598.)	(474398.)	(C) Oil 39.42% Gas 60.58%
Exp. of Lse. Aband'ts Over Allow.	490413.	294248.	196165.	(A) " "
Exc. of Dry Hole Costs Over Allow.	1324434.	794660.	529774.	(A) " "
Contributions Unallowable	81080.	81080.		
Depr. Charged Clearing Accts. on Exs.	311772.	99990.	211782.	(C) Oil 27.03% Gas 72.97%
Net Adj. of Clearing Accts. - Per Exs.	140720.	19432.	50814.	(C) Oil 27.03% Gas 72.97%
Misc. Adjs. Various Exp. Unallowable	(91570.)	(24734.)	(66836.)	(C) " "
Misc. Income Adjustments	121459.	51455.	69504.	(B) Oil 37.57% Gas 62.43%
Misc. Tax Exp. Adjs. - Net	77305.	1552.	75753.	(C) Oil 27.03% Gas 72.97%
Gain on Property Sales - Net	47138.	-	47138.	Tax Returns Direct
Sub-total		811452.	1522154.	
TAX ADJUSTMENTS - MINUS				
Depreciation for Tax Purposes	4570479.	1990978.	2579501.	Tax Return - Direct
Depletion for Tax Purposes	1240324.	482477.	757847.	" " "
Intangible Drilling Costs	1534528.	571993.	962535.	" " "
Amort. Past Serv. Pension Payments				
Production Payments Adjustment				
Amort. Bond Expense Adjustments	1995.	711.	1284.	(D) Oil 37.57% Gas 62.43%
Delay Rentals - Capitalized on Exs.	1442374.	571884.	870490.	(A) Oil 39.65% Gas 60.35%
Transfer Between Accts.	45492.	-	45492.	Tax Return - Direct
Advance Royalty Bonus Exhaustive	421295.	403554.	217741.	Tax Returns - Direct
Sub-Total		1028179.	1528049.	
Total		(216727.)	(5855.)	
Taxable Income per Ret. (Sch. 2 A.F.I.)	4237452.			
Oil	2801392.			
Gas	(431732.)			
Total	4237452.			

Schedule No. 12

UNITED GAS PIPE LINE COMPANY
INCOME AND DEDUCTIONS OF UNION PRODUCING COMPANY
APPLIED IN DETERMINATION OF TAXABLE INCOME AS SHOWN IN CONSOLIDATED FEDERAL INCOME TAX RETURN
SHOWING AMOUNTS ATTRIBUTABLE TO OIL AND TO GAS
1961

	Total Per Books	Total Oil	Total Gas	Basis of Assignment to Oil and to Gas
Operating Revenues	62,69[illegible]	[illegible]	32,53[illegible]	Direct
Operating Expenses	18,42[illegible]	6,47[illegible]	11,94[illegible]	"
Depreciation and Depletion	7,92[illegible]	[illegible]	[illegible]	Not used for tax purposes
Dry Holes	2,01[illegible]	9,03[illegible]	1,30,[illegible]	(a)
Unproven Leases - Abandoned	4,27[illegible]	1,78,[illegible]	2,49,[illegible]	(a)
Taxes	5,05,[illegible]	1,72,[illegible]	3,32,[illegible]	Direct - Per Books
Total Operating Revenue Deductions	37,88[illegible]	10,85,[illegible]	19,02,[illegible]	" " "
Net Operating Revenue	25,02,[illegible]	9,21,[illegible]	14,50,[illegible]	" " "
Revenue from Lse.-Other Phys. Prop.	196,122.	58,755	137,367.	(a) 37.27% 62.73%
Interest Revenues	985,126.	371,098	614,028.	(a)
Misc'l. Non-Operating Revenues	1,99[illegible]	80,825	87,800	(b)
Non-Operating Revenue Deductions	-	-	-	(b)
Total Other Income	2,[illegible]	1,26,738.	2,708,192.	
Gross Income	25,04,[illegible]	9,34,[illegible]	14,58,[illegible]	
Interest Expense	2,40,[illegible]	82,[illegible]	1,31,[illegible]	(a) 37.27% 62.73%
Interest During Construction (Cr.)	46,[illegible]			Not used for tax purposes
Miscellaneous Income Deductions	98,[illegible]	93,[illegible]	5,[illegible]	Direct - Per Books adj. 21.27% 78.73%
Total Income Deductions	2,[illegible]	92,[illegible]	1,31,95,[illegible]	
Net Income Per Books	12,85,[illegible]			
Totals - Forwarded		9,46,82,[illegible]	13,23,90,[illegible]	

Note: See Schedule No. 13 attached for derivation of percentages used for assignment to Oil and Gas

	Total	Oil	Gas	Basis of Assignment to Oil and to Gas
Forward		9,46,82,[illegible]	13,23,90,[illegible]	
TAX ADJUSTMENTS - PLUS				
Excess of Oen.Depletion,Pay.Over Allow.	34,[illegible]	14,[illegible]	20,[illegible]	(a) 42.93% 57.07%
Excess of Lse. Abandd'ts Over Allow.	76,[illegible]	32,[illegible]	44,[illegible]	(a) 42.93% 57.07%
Excess of Dry Hole Costs Over Allow.	2,[illegible]	1,[illegible]	1,[illegible]	(a) 42.93% 57.07%
Contributions Disallowable	93,403			
Depr.Charged Clearing Accts.on Exs.	462,[illegible]	179,[illegible]	282,[illegible]	(a) 38.82% 61.18%
Net Adj.of Clearing Accts.-Per Exs.	118,[illegible]	33,[illegible]	84,[illegible]	(a) 28.02% 71.98%
Misc'l.Adjs.Various Pay.Unallowable				
Misc'l. Income Adjustments	263,625	79,[illegible]	184,[illegible]	(a) 29.67% 70.33%
Misc'l. Tax Exp.Adjs. - Net	(372,[illegible])	(121,[illegible])	(251,[illegible])	(a) 32.58% 67.42%
Gain on Property Sales				
	140,[illegible]		140,[illegible]	TAX RETURN - DIRECT
Sub-total		856,[illegible]	1,37,31,[illegible]	
TAX ADJUSTMENTS - MINUS				
Depreciation for Tax Purposes	4,32,771	1,70,052	2,62,719	Tax Return - Direct
Depletion for Tax Purposes	13,08,908	3,85,[illegible]	7,91,[illegible]	" " "
Intangible Drilling Costs	4,54,[illegible]	1,48,[illegible]	2,66,[illegible]	" " "
Amort. Past Serv. Pension Payments	2,[illegible]	(60)	(1,[illegible])	(a) 42.93% 57.07%
Production Payments Adjustment	72,993	27,[illegible]	45,[illegible]	(a) 37.27% 62.73%
Amort. Bond Expense Adjustments	1,[illegible]	[illegible]	1,[illegible]	(a) 35.53% 64.47%
Delay Rentals - Capitalized on Exs.	12,[illegible]	5,[illegible]	7,[illegible]	(a) 42.57% 57.43%
Excess Book Retirement Accts.	98,171	-	98,171	TAX RETURN - DIRECT
Sub-Total		9,23,[illegible]	13,98,[illegible]	
Total		(70,[illegible])	40,[illegible]	
Taxable Income per Ret. (or R.A.R.):	(66,[illegible])			
Oil	(29,[illegible])			
Gas	[illegible]			
Total	(66,[illegible])			

Schedule No. 13

	Checked	Date
Prepared by		
Examined by		

United Gas Pipe Line Company

Explanation of derivation of percentages used for assignment to Oil and to Gas

(A) Ratio of Unions applications and development costs to Oil and to gas for respective years

(B) Ratio of Unions gross operating revenues from oil and from gas as shown in Federal income tax returns for respective years

(C) Ratio of Unions operating expenses to oil and to gas per books, adjusted to tax basis per Federal income tax returns for respective years

(D) Ratio of Unions net plant to oil and to gas for respective years

(E) Ratio of Unions taxes to oil and to gas per books for respective years

(F) Ratio of each years current pension expense to oil and to gas per books for respective years

Exhibit

United Gas Pipe Line Company Exhibit 14-6 — Summary of Tax Effects of 1962 Rate Refund applied to years in which affected revenues were received as compared with tax effect arising from rate income reduction in 1962.

FPC Docket No. RP64
Exhibit No. ——
Witness: W.B. Moore

	Initials	Date
Prepared By		
Approved By		

United Gas Pipe Line Company

Summary of Tax Effects of 1962 Rate Refund applied to years in which the affected revenues were received as compared with Tax Effects arising from rate refund deduction in 1962

	(1)	(2) Tax Liability Allocated to Pre-Refund Period	(3) Tax Liability Allocated to U.G.P.L. Co. Refund	(4) Difference
1956 - R.A.R.		$ 11710 900	$ 9899795	$ 2811105
1957 R.A.R.		12249608	8079975	4170528
1958 R.A.R.		13999756	11392398	2607358
1959 R.A.R.		9778220	7796350	2021870
1960 Refund		7164820	5082782	2081738
1961 Refund		7998911	5883288	2115623
				$ 15836722
1962 Estimated Tax Liability of U.G.P.L. Co. on Consolidated return basis before giving effect to the rate reduced deduction				7665665
U.G.P.L. Co's portion of Consolidated Tax Liability for 1962 before giving effect to the Consolidated loss carryback arising in 1962 as a result of the rate reduced deduction			$ 9978 770	
Reimbursement of 1962 Consolidated Tax liability after giving effect to the loss carry-back deduction for U.G.P.L. Co's portion of such reduced tax liability			6177 785	
Refund to be received by U.G.P.L. Co.				$ 3796 485
Total Reduction of Refund to be to U.G.P.L. Co. as a result of rate reduced deduction				$ 19463 207

Memphis Light, Gas and Water Division Exhibit 36 (Revised) Summary of taxable income (or loss) in consolidation, United and subsidiaries, years 1957 through 1961, inclusive.

Exhibit 36 (Revised) 1/

UNITED GAS PIPE LINE CO.
Docket No. RP63-1

Summary of Taxable Income or (Loss) in Consolidation
United Gas Corporation and Subsidiaries
Years 1957-1961, Inclusive

Line No.		Amount
	1957	
1	United Gas Corp.	$ 2,743,517
2	United Gas Pipe Line Co.	25,615,779
3	Union Producing Co.	(2,269,975)
4	Consolidated Taxable Net Income	26,089,321
	1958	
5	United Gas Corp.	3,528,821
6	United Gas Pipe Line Co.	22,573,974
7	Union Producing Co.	4,852,736
8	Consolidated Taxable Net Income	30,955,531
	1959	
9	United Gas Corp.	2,939,594
10	United Gas Pipe Line Co.	20,943,401
11	Union Producing Co.	(1,958,398)
12	Consolidated Taxable Net Income	21,924,598
	1960	
13	United Gas Corp.	2,700,979
14	United Gas Pipe Line Co.	17,569,439
15	Union Producing Co.	(4,333,704)
16	Consolidated Taxable Net Income	15,936,714
	1961	
17	United Gas Corp.	(2,888,741)
18	United Gas Pipe Line Co.	18,588,390
19	Union Producing Co.	(160,285)
20	United Overseas	(24,354)
21	Consolidated Taxable Net Income	15,515,010
	1957-1961, Inclusive	
22	United Gas Corp.	9,024,170
23	United Gas Pipe Line Co.	105,290,983
24	Union Producing Co.	(3,869,626)
25	United Overseas	(24,354)
26	Consolidated Taxable Net Income	110,421,173

7116-7118 FPC Order providing for hearing suspending proposed revised tariff sheets and fixing date of hearing issued 7-27-62.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Joseph C. Swidler, Chairman; Howard Morgan, L. J. O'Connor, Jr., Charles R. Ross and Harold C. Woodward.

United Gas Pipe Line Company) Docket No. RP63-1

ORDER PROVIDING FOR HEARING, SUSPENDING PROPOSED REVISED TARIFF SHEETS, AND FIXING DATE OF HEARING

(Issued July 27, 1962)

United Gas Pipe Line Company (United) on June 15, 1962, tendered for filing certain revised tariff sheets 1/ to be included in its FPC Gas Tariff, First Revised Volume No. 1, proposed to become effective on August 1, 1962 2/, and providing for an annual increase in its rates and charges of $5,600,000 or four percent, to its jurisdictional customers, based upon sales for the year ended March 31, 1962, as adjusted. 3/ The supporting statements accompanying the tendered filings are prepared in the form of exhibits and prepared testimony in substantial compliance with the Commission's proposed regulations which are now under consideration in Docket No. R-207 as issued February 20, 1962.

1/ The tendered filing includes:
First Revised Sheets Nos. 5, 7, 50, 67, 75, and 84.
Second Revised Sheet No. 3.
Fourth Revised Sheet No. 99.
Fifth Revised Sheets Nos. 1, and 102.
Sixth Revised Sheets Nos. 34, 35, 44, and 45.
Seventh Revised Sheets Nos. 103, and 104.
Eighth Revised Sheets Nos. 4, 6, 10, 12, 16, 18, 21, 23, 25, 27, 28, 30, 32, and 100.
Ninth Revised Sheet No. 101.

2/ The settlement agreement approved by Commission order issued March 1 1962, provides for a continuation of proposed rates in Docket No. RP61-18 until December 31, 1962, subject to certain audit and refund procedures. United indicates it will move in this proceeding to make the proposed increased rates effective on January 1, 1962, if the Commission suspends them for the full five months statutory period from August 1, 1962.

3/ The increased rates and charges proposed herein would be in addition to the increased rates and charges subject to audit and refund in Docket No. RP61-18.

DC 30

In support of its proposed increased rates and charges, United primarily relies upon claimed increases in the cost of purchased gas due to shifts in sources of supply to higher priced gas and increased rates of its existing suppliers, increased costs due to new facilities, and lower sales due to the loss of load in San Antonio, Texas. United claims the need for a 6.5% rate of return on its own rate base, and claims need for 11% rate of return on the rate base of its affiliate, Union Producing Company (Union), whose costs are shown in support of the contract prices included in United's cost of purchased gas. In addition, United computes its Federal income tax liability using a 52% rate without reflecting the lower consolidated effective tax rate paid by United's parent company, United Gas Corporation.

United has not fully supported its proposed increased rates and charges in several respects, including, but not limited to, cost of purchased gas, estimated sales volumes associated with new facilities, rate of return, Federal income taxes, the utilization of a zone-by-zone method of allocation of costs, and in the level of the demand-commodity components of the proposed rates and charges. 4/ Furthermore, a number of United's supplier's rates are presently being collected by those suppliers subject to refund. Some of these supplier proceedings have been the subject of settlement negotiations resulting in rate reduction and refund agreements which have recently been approved or submitted to the Commission for its approval. 5/ In addition, proceedings involving Union's rates in Docket Nos. G-13811, et al., are now before the Commission, the Presiding Examiner having issued a decision therein on June 26, 1962. These supplier proceedings involve, in the aggregate, a possibly larger reduction in United's purchase gas costs than the amount of the rate increase filed for by United herein.

The increased rates and charges and the changes in tariff form and rate design contained in the revised tariff sheets tendered for filing on June 15, 1962, as aforementioned, have not been shown to be justified, and may be unjust, unreasonable, unduly discriminatory, preferential, or otherwise unlawful.

4/ Willmut Gas and Oil Company v. F.P.C., 297 F. 2d 112.

5/ Tidewater Oil Company, et al., Docket Nos. G-13310, et al., order approving general rate settlement, issued June 15, 1962, as modified by order issued July 11, 1962; The Ohio Oil Company, Docket Nos. RI60-92, et al., issued June 28, 1962; Shell Oil Company, Docket Nos. G-13397, et al., settlement agreement certified by Presiding Examiner to Commission on June 19, 1962.

The Commission finds:

It is necessary and proper in the public interest and to aid in the enforcement of the provisions of the Natural Gas Act, that the Commission enter upon a public hearing concerning the lawfulness of the rates, charges, classifications, and services contained in United's FPC Gas Tariff, First Revised Volume No. 1, as proposed to be amended by the revised tariff sheets tendered for filing on June 15, 1962, and that said revised tariff sheets and the rates contained therein be suspended and the use thereof deferred as hereinafter provided.

The Commission orders:

(A) Pursuant to the authority of the Natural Gas Act, particularly Sections 4 and 15 thereof, the Commission's Rules of Practice and Procedure and the Regulations under the Natural Gas Act [18 CFR, Chapter I], a public hearing be held pursuant to the procedures to be prescribed by further order, concerning the lawfulness of the rates, charges, classifications, and services contained in United's FPC Gas Tariff, as proposed to be amended by the aforementioned revised tariff sheets tendered for filing on June 15, 1962.

(B) Pending such hearing and decision thereon, United's revised tariff sheets, as tendered for filing on June 15, 1962, and the rates and charges contained therein, are hereby suspended and the use thereof deferred until January 1, 1963, and until such further time as they may be made effective in the manner prescribed by the Natural Gas Act.

(C) Notices and petitions to intervene may be filed with the Federal Power Commission, Washington 25, D.C., in accordance with the Commission's Rules of Practice and Procedure, Sections 1.8 and 1.37 (f) [18 CFR 1.8 and 1.37 (f)] on or before August 20, 1962.

By the Commission.

Joseph H. Gutride,
Secretary.

Effective Tax Rate

United's cost of service includes Federal income taxes in the amount of $12,099,662 calculated at the statutory 52% rate. Staff proposes that the Federal income tax component be reduced to $6,655,871 based on a consolidated effective tax rate for the tax year of 46.82% plus investment credit deductions. Memphis suggests a further reduction of such allowance to $3,923,208, or under certain alternative theories, to zero.

United Gas Corporation, together with its wholly-owned subsidiaries, United, Union, and Overseas, files a consolidated income tax return, as is its privilege under Section 1501 of the Internal Revenue Code of 1954, in lieu of separate returns for each company. Union had $8,722,362 of gross tax losses between 1957 and 1961 (Exh. 36, rev.) and a net total tax loss during this period of $3,869,326. This tax loss resulted from Union's use of the statutory percentage depletion allowance resulting from the exploration, development, and operation of its oil and gas properties. Union is not a regulated public utility within the meaning of the Federal income tax law (Tr. 490) and its sales of oil and other related products are unregulated and outside the jurisdiction of the Commission.

The effect of the consolidated income tax return during the years in which Union has a tax loss is to reduce the total income tax liability of all the affiliated companies, including United, below the total of what they would pay on a separate return basis. Staff and Memphis take the position that all of the affiliates should be treated as a single entity and the lower effective tax rate resulting from the consolidated return should be applied in computing the amount of Federal income taxes includible in United's cost of service.

United insists that it is entitled to apply the statutory 52% income tax rate unreduced by the utilization in the consolidated return of deductions and losses attributable to the unregulated, non-jurisdictional, and non-utility operations of affiliates. Losses resulting from unregulated, non-jurisdictional oil operations in particular should not be considered for rate-making purposes. Staff believes United is entitled to share equitably in the consolidated tax return savings produced by Union's tax losses on the ground that Union is United's integrated production arm and recovers its exploration and development costs through prices it charges its customers -- prices ultimately borne by United's customers. Staff also relies on the doctrine of "taxes actually paid" 9/. United contends that its customers bore none of the expenses of Union's non-utility operations and are not entitled to have their rates reduced by virtue of Union's losses.

As noted by United, (Br. p. 53) the issue here is essentially the same as that now pending before the Commission in the matter of Cities Service Gas Co., Docket No. 18799, on exception from Examiner Kelly s

9/ Citing El Paso Natural Gas Co. v. FPC, 281 F.2d 567 (1960) and similar cases.

decision dated April 23, 1962. There the Examiner allowed City Service to compute its Federal income tax component at the statutory 52% rate on the ground that the actual taxes paid doctrine, which requires any tax savings to be passed on to the consuming public, applies only to tax savings related to and derived from the regulated companies' jurisdictional gas business. Examiner Kelly's conclusions were concurred in approximately one month later on May 28, 1962, when Examiner Zwerdling in Tennessee Gas Transmission Co., Docket No. G-19983, rejected the consolidated effective tax rate proposed by the Staff 10/ which would have resulted in a lower tax rate through the utilization of losses incurred by non-utility and Canadian oil operations. The Tennessee Gas case has now been settled but the Cities Service case is pending before the Commission for decision.

The reasoning of the Examiner in both the Cities Service and Tennessee Gas decisions is persuasive and compels rejection of the Staff position that the income tax component should be reduced from 52% to the consolidated effective tax rate of 46.82% without regard to the character and source of the tax losses giving rise to the tax savings. The El Paso decision does not deal with the specific issue presented here -- whether it is proper to reduce gas rates by utilizing tax losses applicable to unrelated non-utility operations. It does not follow, however, that the 52% statutory rate must be applied. United needs Union's losses to achieve any saving through the consolidated return. Conversely, the loss company needs United's profits to achieve a tax saving for the consolidated group. The necessity of a joint effort suggests the desirability of a division of the tax savings effected.

An effective tax rate of 49.51% produces an equitable division of the tax savings between the profit and loss companies involved in this proceeding. This rate is derived as follows:

First, we determine the total amount of taxable income for all companies in the consolidation having taxable income for the test year. The

---

10/ Staff's initial brief does not make reference to either Cities Service or Tennessee Gas. Its reply brief contains the following reference:

> United cites the Examiner's decisions in the Cities Service and Tennessee Gas cases as authority for its position on the consolidated effective tax rate issue. We point out, however, that there was a contrary Examiner's decision in the Northern Natural case which it has been unable to distinguish and that this issue is presently before the Commission for decision (p. 31).

effect of this is to ignore the "loss" companies since they pay no tax. The total amount of taxable income of the "profit" companies is $122,056,630 for the 1957-61 period as derived from Appendix A-1 A/ of the Memphis brief. We use an average of taxable income for five years from 1957 to 1961, in determining the effective tax rate in order to avoid the distortion that might result from the use of a single year.

We then apply the 52% statutory tax rate to the total amount of taxable income to arrive at the total tax liability. The same result would be accomplished if these companies having taxable income had filed separate returns and paid their taxes on the basis of the 52% rate. In the instant case, the application of the 52% rate to $122,056,630 results in an income tax liability of $63,469,447 which, of course, relates to the "profit" companies, or those having taxable income during the test year.

We then deduct the amount of the Federal income tax paid in filing the consolidated return, from the amount of the tax liability determined on the separate return basis. The difference thus derived represents the amount of the tax saving resulting from the filing of the consolidated return. In the case at hand, the amount of $57,386,940, representing the consolidated tax payment for the period 1957-61, is deducted from the amount of $63,469,447 representing the tax determined on a separate return basis for the "profit" companies, to arrive at the amount of $6,082,507 representing the tax saving.

Finally, we divide the tax savings. This is accomplished by first multiplying the tax saving of $6,082,507 by 50%, and then dividing the resultant figure of $3,041,253 by the amount of the tax figured on a separate return basis of $63,469,447, thereby arriving at a percentage of 4.7917. The 4.7917% is multiplied by 52% to arrive at another percentage of 2.492. This percentage of 2.492 is then deducted from the 52% statutory rate to arrive at 49.51% as the effective tax rate for application to the taxable income of United.

The dollar effect of an effective tax rate of 49.51% is shown by its application to the net taxable income of United presented in the exhibits of United, Memphis, Interveners, and Staff B/. The resultant tax liability for United is reduced to $11,520,011, as compared with United's proposed tax liability of $12,099,662, or a reduction of $579,651; increased to $4,022,543, compared with $3,923,208, proposed by Memphis, an increase of $99,335; increased to $5,886,718 as compared with $5,452,481 proposed by Staff, an increase of $434,237.

9113-9166 Excerpts from Opinion No. 428 and Order determining rates and providing for refunds issued May 14, 1964.

9113-9150 From Majority Decision by Black, Commissioner.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Joseph C. Swidler, Chairman; L. J. O'Connor, Jr., Charles R. Ross, Harold C. Woodward and David S. Black.

United Gas Pipe Line Company Docket No. RP63-1

OPINION NO. 428

OPINION AND ORDER DETERMINING RATES AND PROVIDING FOR REFUNDS

(Issued May 14, 1964)

BLACK, Commissioner:

This proceeding arises under Section 4(e) of the Natural Gas Act upon a filing by the United Gas Pipe Line Company on June 15, 1962, seeking an annual increase in the rates and charges to United's jurisdictional customers of approximately $5,600,000, to be effective August 1, 1962. The United Gas Pipe Line Company is a large pipeline system operating in Texas, Louisiana, Mississippi, Alabama and Florida. (See map, Appendix 1). It purchases gas from producers including its affiliate Union Producing Company and sells gas for direct consumption by industrial customers and for resale by towns, distribution systems and pipelines which in turn transport gas to the mid-continent and the eastern seaboard. Both United and Union are owned entirely by United Gas Corporation which also operates distribution systems in Texas, Louisiana and Mississippi. Events subsequent to United's filing, primarily producer rate reductions, so reduced United's jurisdictional costs that the jurisdictional increase became a net rate increase of only $1,600,000 as of January 1, 1963. 1/

By Commission order of July 27, 1962, the proposed increased rates were suspended until January 1, 1963, on which date they became effective, 2/ subject to refund of all amounts collected above those found to be just and reasonable in this proceeding. The hearing commenced on November 27, 1962, after service of the direct case in chief and exchange of proposed testimony and exhibits pursuant to the expedited hearings procedure

---

1/ Since the close of the record there have been further producer rate reductions so that the jurisdictional increase of $1,600,000 would become a $600,000 net decrease as of August 30, 1963.

2/ On December 19, 1962, United filed substitute rates to reflect the reduction in its costs which had occurred and these were permitted to become effective January 1, 1963, by Commission order of January 17, 1963.

prescribed by the Commission on August 6, 1962 (28 FPC 295). 3/ The examiner's decision was issued on June 17, 1963, and upon request of the parties in their exceptions thereto, 4/ oral argument was held before the Commission on September 20, 1963. The proceedings, involving numerous issues, are now before us on these exceptions to the examiner's decision.

On some of the issues there is no dispute. One of these is the rate of return on which United presented evidence, but the staff, United and all participants stipulated 6.5 percent as the fair rate of return. Other matters not in dispute are depreciation and taxes other than income tax. Included in the cost of purchased gas are payments under rates which are subject to Commission proceedings; United therefore agrees that the rates determined in this proceeding will be subject to adjustment to reflect final determination of any such conditionally effective gas purchase prices included in the cost of service. The remaining issues relating to (1) the test period, (2) the cost of service including the cost of purchased gas, federal income taxes, the amount of prepaid gas in the rate base, (3) allocation of costs, and (4) the design of rates, are strongly contested by the parties. Also certain interveners contend that the expedited hearing procedures have substantially deprived them of their rights to due process. Included within the issue pertinent to federal income taxes was a question of far reaching significance to the natural-gas and electric utility industries as a whole, the proper treatment for rate making purposes of the investment tax credit authorized by the Internal Revenue Act of 1962. However, subsequent to the argument of this case Congress has prescribed that such investment tax credits shall not be used to reduce the pipeline's federal income taxes for the purpose of establishing the cost of service without the consent of the company. Therefore this is no longer an issue in the case.

TEST PERIOD

United filed its rate increase on June 15, 1962, with a base period of 12 months ending March 31, 1962, with adjustments for newly constructed facilities to go into service before November 30, 1962. United contends,

---

3/ The order of August 6, 1962 directed United to serve its direct case in chief by August 21, 1963, interveners and staff to serve their proposed testimony and exhibits by October 1, 1962, and that a pre-hearing conference be held on October 22, 1962. These dates were complied with by the parties. The pre-hearing conference set November 19, 1962, as the date for filing of United's rebuttal case. The hearing lasted from November 27, 1962 through January 28, 1963. Briefs and reply briefs were thereafter exchanged.

4/ Mississippi River Fuel Corporation, Mississippi Valley Gas Company, United Gas Pipe Line Company (7/5/63); Texas Eastern Transmission Corporation, Southern Natural Gas Company, Commission staff, Memphis Light, Gas and Water Division, Willmut Gas and Oil Company, Laclede Gas Company, Texas Gas Transmission Corporation and Louisville Gas and Electric Company, Western Kentucky Gas Company, Public Service Electric and Gas Company, et al. (Eastern Intervenors), Natural Gas Pipeline Company of America (7/8/63); Southern Union Gas Company, Tyler Gas Service Company (7/9/63)

and the examiner agrees that this is in compliance with Section 154.63(e)(2)(1) of the Commission's regulations, which provide in part as follows:

> ". . . based upon a test period which shall consist of a base period of 12 consecutive months of most recently available actual experience, adjusted for changes in revenues and costs which are known and are measurable with reasonable accuracy at the time of the filing, and which will become effective within nine months after the last month of available actual experience utilized in the filing, but in no event shall such test period extend six months beyond the date of filing."

Staff, however, argues that rates for the future are not set for a single year but for a future period of indeterminate duration upon the basis of normalized conditions. Thus staff contends that we should make adjustments to the test year sales presented by United so that we would reflect the revenue increase experienced by the company as a result of its investment in new facilities put in service April 1, 1961 through November 30, 1962, and included in the test year rate base. For this purpose the staff adopted an estimate of 1963 sales presented by United. On the other hand United argues that staff use of estimated 1963 sales has the same effect as if staff were to use an estimated 1963 test year in violation of the Commission's historic policy requiring filing data based on a test period of the latest 12 months of actual experience adjusted for known changes occurring within a stated period.

Of course, it is common in rate cases to adjust cost of service items, particularly items of expense, where a change has been made after the end of the test year. In the present case the situation is peculiar, and something more than the usual adjustment is required. United's claimed rate base includes $56,248,618 of newly certificated gas facilities which were not in service throughout the base period, but were scheduled to become operative on or before November 30, 1962. These facilities include the important new line from southern Louisiana to Sterlington in northern Louisiana. Costs associated with the new facilities include depreciation, return, and state and federal taxes. The record shows that these new facilities would be used for sales made after the proposed rates took effect on January 1, 1963. In supporting its proposed rates for a future period it was proper for United to include these facilities, for if it had confined its presentation to an average of net plant in existence during the period ending March 31, 1962, the cost results would not have been representative of the future period when the rates would be in effect. By the same token the staff was also proper in contending that 1963 sales should be taken into account instead of the test year sales presented by United. The 1963 sales amount to 1,343,703,213 Mcf at 14.9 psia, as shown by United in its rebuttal case and as adopted by the staff. Furthermore, upon consideration of certain adjustments made by the staff, the record shows that this volume of gas is not an estimate of all the gas to be delivered in 1963 but is limited to that which can be handled by the normalized March 31, 1962, test year facilities.

In our opinion, United misconceives the purpose of the Commission's regulations with respect to a filing of a proposed rate change. The Commission intended, as United notes, that its amended regulations expedite proceedings by providing for the submission of extensive data in support of the rate filing, so that this material would not have to be obtained in a time consuming investigation after the filing of the proposed changes. The Commission stated in amending its regulations, again as noted by United, that the applicant might adduce additional material or present data on a different basis to the extent desirable, but that the supplemental material must relate to the prescribed test year (28 FPC 495). Obviously adjustment by the company may require offsetting adjustments by other parties. In the past we have used a test year "with adjustments for know... changes occurring within a reasonable time." Panhandle Eastern Pipe Line Co., 25 FPC 787, 795, remanded on other grounds Panhandle Eastern Pipe Line Co. v. F.P.C., 305 F. 2d 763, (CADC, June 30, 1962), certiorari denied 372 U.S. 916; see also El Paso Natural Gas Co., 22 FPC 260, 263, remanded on other grounds El Paso Natural Gas Co. v. F.P.C., 281 F. 2d 567 (C45), certiorari denied 366 U.S. 912. The objective is to present adjustments to the test year figures which will match additional expenses with additional income as close as is reasonably possible. What is reasonable obviously depends upon the circumstances. Since extensive facilities were put into service in 1962, so as to change the company's operations substantially in 1963, it was proper to employ 1963 volumes of gas with the March 31, 1962 test year cost of service adjusted incrementally to these increased volumes of gas.

COST OF SERVICE

There are several cost of service matters at issue between the parties. These include purchased gas costs (including the amount paid to United's affiliate, Union Producing Company), federal income taxes, and the computation of the rate base including the question whether there should be an allowance for prepaid gas costs.

A. Purchased Gas Costs - The cost of purchased gas represents about 75 percent of United's cost of service. 5/ Controversy arises over

---

5/ $249,169,755 out of a total cost of service of $325,731,603, as determined herein.

the estimated purchasing pattern for the year 1963 compared with the test year ending March 31, 1962. United's average cost of gas purchased during the base year was 17.71 cents per Mcf. Under its adjusted gas purchase pattern for 1963, including increased takes from the higher priced fields in Southern Louisiana, the unit cost rose to 18.40 cents. The witness for United testified that the purchase pattern was one of judgment in applying a formula which took into account a number of factors including the capacity of its system, availability of gas, state conservation statutes, the takes of other purchasers within the field and drainage conditions. The staff, on the other hand, argued that United had not taken into account the element of cost. It constructed a purchase pattern of its own for the Houston and Lafayette districts. It used United's adjusted average cost of gas derived from United's adjustment of test year costs and volumes to November 30, 1962. On our part we are convinced by the evidence that the dispatching of gas from the various fields to meet the obligations of the pipeline is a very complicated activity particularly in view of contract obligations and the state regulation of takes. An adequate supply of gas might be threatened if United were to be required to take the lower priced gas. It seems obvious to us that if United were required to use the lowest priced gas first, it would result in an accelerated increase in purchased gas costs.

As set forth by the examiner whose views we are adopting here, United included in its purchased gas costs approximately $18,600,000 paid to Union, a wholly owned gas producing subsidiary of United's parent, for approximately 131,000,000 Mcf of gas at an average cost of 14.2 cents per Mcf. The prices used by United are based on rate schedules of Union filed with this Commission. To support the prices paid, United put in a complete cost of service case based on Union's 1961 costs. Staff and interveners moved to dismiss this evidence on the ground that Union's rates were the subject of a proceeding in Docket No. G-13811. The examiner granted the motion on the ground that the Union proceeding provided an adequate vehicle for the determination of that portion of United's cost of service represented by gas supplied by Union and to turn this pipeline rate proceeding into a de novo full-blown investigation of the economic justification of Union's price to United would duplicate a producer rate proceeding. In his decision the examiner reaffirmed this position.

Applicable to this proceeding is the authority of Mississippi River Fuel Corp. v. F.P.C., 252 F.2d 619 (CADC), certiorari denied 355 U.S. 904. There in a case involving United's rates the Commission said that while it was empowered to inquire into United's contract prices with Union, it was not required to do so and its not doing so was a reasonable exercise of administrative discretion. The court, however, held that the Commission should have inquired into Union's prices saying:

"Therefore we think the Commission must at least inquire into the factual justification for the price increases paid by United to Union. By this we mean that to include the increased prices in the costs of United the Commission must at least determine that the increases were justified by reason of Union's costs or by reason of some other stated end of the Natural Gas Act; the Commission must ascertain that they were not mere bookkeeping or intra-corporate-system adjustments. We must remand the case for that inquiry. We do not hold that a full-blown inquiry into the rates of Union is necessary. Subsequent developments in the proceeding may or may not indicate such a necessity."

In Willmut Gas and Oil Company v, F.P.C., 299 F.2d 111 (CADC) the Commission also had rates of United before it. After the decision in the Mississippi River Fuel case United sought to reopen the hearing so that evidence might be offered to substantiate the amounts for cost of gas purchased from Union. The Commission refused to receive such evidence, but on review confessed error and asked that matters be remanded for further proceedings concerning the factual economic justification for Union's charges.

In view of these decisions it is entirely clear that we would be remiss in accepting Union's filed rates for United's purchased gas costs. The courts, in effect, place the filed rates of an affilate in a different category than those of a non-affiliate. This follows reasonably because, as the court said, we are dealing with a single corporate structure. We must therefore do something more than accept the filed rates, as United would have us, but we are not required to include a full-blown inquiry into Union's rates in the present proceeding.

We have a means of meeting the requirements of the court in these cases without initiating another rate case for Union. We have had before us the proceeding in Docket No. G-13811, et al., relating to Union's rates. This is an investigation under Section 5(a) of the Act consolidated with eight Section 4(e) dockets covering nine rate schedules of Union's charges to United. Of the eight Section 4(e) dockets involved 6/ only three have not been superseded by subsequent rate filings and represent sales in 1963. 7/ In our Opinion No. 414 issued on January 9, 1964 we determined that Union had

---

6/ G-13811, G-13820, G-14114, G-14352, G-14553, G-16725, G-17589, and G-17606.

7/ G-14114, G-14552 and G-17589 excluding the effect of a filing to reflect the unconstitutional Louisiana gas gathering tax. (See Appendix 3.)

failed in its proof to support the Section 4(e) rates, but that the record was not sufficient to make a determination of Union's rates for the future particularly with respect to the matter of depletion. Therefor we disallowed Union's increased rates proposed in the Section 4(e) dockets and remanded the proceedings so that the record could be amplified for the purposes of the Section 5(a) investigation (Docket No. G-18354). In doing so we required that Union adduce evidence with respect to a more current test year.

In the present proceeding it would be inappropriate to determine Union's rates even if the record were complete, for it would be wasteful to determine Union's rates in two proceedings possibly with inconsistent results. We shall therefore leave the question of the cost of gas purchased from Union undecided to await the final result in the Union case. This, in our opinion, will meet the criteria of the court in the Mississippi case that a factual economic justification for Union's rates be shown. For the period here involved beginning with January 1, 1963, we shall accept as United's purchased gas costs Union's filed rates (even though subject to suspension in other proceedings) except for the filed rates covered by dockets in the Union case and still not superseded. In the case of those unsuperseded Union rates we shall accept only the rates in effect previous to the Union case filings, for we have already found those rates unjustified. Upon final determination of Union's rates we shall require United to file rate reductions if appropriate and to refund to its customers amounts which represent the difference between what it has paid for gas and what it should have paid if the rates finally determined in the Union case had been in effect.

studies, as noted, were based on a period extending back to 1949, but since the unit costs and incremental costs levelled out with some variations at about 2 cents in the 1954-1961 period we shall use the rounded figure of 2 cents to compute the adjustment of operating expenses so as to reflect the 1963 gas volumes. This, of course, does not prevent us finding in another case and under different circumstances that additional volumes of a pipeline's gas can be sold without an equivalent increase in operating expenses so that the unit operating cost of the additional gas would, indeed be lower than the unit operating cost of the original gas. The Commission is not ruling that the method of determining incremental costs in this opinion is the only acceptable method.

Apart from the 2-cent factor United has made certain errors, in computing its adjustment to operating expenses as contended by the Eastern Intervenors. United computed its incremental volume to be 86,868,613 Mcf apparently by deducting its adjusted March 31, 1962, test year volumes in the amount of 1,310,305,755 Mcf from the estimated 1963 volumes in the amount of 1,397,174,368 Mcf. 8/ Its adjustment of the test year volumes was apparently to compensate for loss of certain sales, but it made no corresponding adjustment in operating expenses. Therefore we shall subtract the unadjusted test year volumes in the amount of 1,323,015,653 Mcf from the 1963 estimated volumes of 1,397,174,368 Mcf to arrive at an incremental volume of 74,158,715 Mcf and an incremental cost (at 2 cents per Mcf) of $1,483,174 instead of United's $1,737,372, thus reducing United's incremental cost by $254,198.

Further, United added $224,514 in operating expenses reflecting the new 30-inch North Louisiana pipeline and a 36-inch pipeline from the Bastian Bay Field. Since the 2-cent cost allowance is designed to take into account all increases in cost, this adjustment represents an additional allowance for the same thing and should not be included in the allowance for the additional volumes of gas. Also United indicated that an amount of $349,237 should also be eliminated from operating expenses representing expenses under an agreement with Texas Gas for transportation which had ceased. Therefore using the 2 cents per Mcf for the incremental gas and taking into account the adjustments shown above there results an allowance for operating expenses, other than purchased gas costs, in the amount of $27,001,997 as shown in Appendix 2 hereto.

As discussed below in connection with taxes there is an issue herein as to whether we should deduct charitable contributions in the amount of $163,322 in computing the income tax allowance. We believe that contributions of a reasonable amount to recognized and appropriate charitable

---

8/ Composed of estimated transportation volumes of 53,471,155 Mcf and sales volumes of 1,343,703,213 Mcf.

institutions constitute a proper operating expense. 9/ Corporations have an obligation to the communities in which they are located and they are expected to recognize this obligation. It is our opinion that these contributions have an important relationship to the necessary costs of doing business.

According to the record, the sum claimed by United is deductible for Federal income tax purposes. Moreover, it represents only about one-twentieth of one percent of United's cost of service. In these circumstances, we shall allow the item of $163,322 as an operating expense; take it into account in computing working capital like other operating expenses; and allocate it in proportion to administrative and general expense. 10/

C. Federal Income Taxes - In its cost of service United has included Federal income taxes in the amount of $12,751,454 calculated at the 52 percent statutory rate in effect at the time the record was closed. We shall use the 52 percent rate as a basis of our computations for it applied through 1963, the first year that our prescribed rates are

---

9/ As a maximum we would allow contributions to those organizations included in the Cumulative List, Organizations described in Section 170(c) of the Internal Revenue Code.

10/ I have prepared this opinion to express the views of the majority, but at this point note my individual disagreement with the Commission's new rate-making treatment of charitable contributions. Such payments, as commendable as they may be, are properly accounted for as income deductions, not operating expenses. They bear no relationship whatever to the necessary costs of providing utility service and therefore should not be borne by the utility customers. Charitable contributions, if made by the Company, should be the sole responsibility of the stockholders. It is argued that a public utility has a community and civic responsibility and should therefore be encouraged to support deserving charities. I agree. But the financial burden of donations to charities should not be shifted to the consumer who had no voice in their selection. A contribution to a charitable organization is uniquely a matter of personal choice and should not be hidden in a customer's gas bill, especially when its beneficial effect may be far removed from his community.

effective. We shall require, however, that United file rate changes to reflect the statutory rates of 50 percent in 1964 and 48 percent in 1965 as prescribed in the Revenue Act of 1964. 11/

1. The Effect of the Consolidated Return.

A question is raised as to United's share of the federal income tax paid through a consolidated tax return filed by United Gas Corporation, its parent. Joined in the return are the subsidiaries, United, Union, and United Overseas Production Corporation. In most years Union shows a loss 12/ with a resulting reduction in taxes for the consolidated group. However, United contends that it is entitled to apply to its taxable income the statutory income tax rate in computing the amount of federal income taxes includible in its cost of service unreduced by utilization of tax reductions and losses attributable to the unrelated, nonjurisdiction and non-utility-operations of affiliated companies.

The question here involved has already been determined by us in Cities Service Gas Company, ___ FPC ___, Opinion No. 396, Docket No. G-18799, Issued July 15, 1963. In that proceeding we stated that the proper method was to (1) separate the companies into regulated and unregulated groups, (2) determine the net aggregate taxable income of each group, and (3) apportion the net total consolidated tax liability over a representative period of time between the two groups and among the companies in the regulated group, on the basis of their respective taxable incomes.

Before making the computation prescribed in Cities Service, it is necessary, as in that case, to decide on the period of time to be used in the computations. The record shows extensive data for the five-year period 1957-1961, and since there are substantial variations in the taxable income for those years, a period as long as this is reasonable. The record does contain some evidence on the year 1962; but, this evidence is in part composed of estimates, and, in any event 1962 is not a typical year for United for tax purposes, because of the rate refunds made that year. Therefore for the purpose of the tax computations we shall use the five-year period 1957-1961.

In making a separation between the regulated and non-regulated companies we find that United is largely a regulated company, and we shall designate it as such for the purpose of these computations. United Gas Corporation engages in the distribution of gas and its rates are variously subject to regulation by state commissions and municipalities.

11/ Public Law 88-272.

12/ United Overseas was not included in the consolidated return until 1961 when it showed a small tax loss.

There is no regulation involved in connection with its sale of gas appliances, appliance repair services, research, and the receipt of interest and dividends. However, since this non-regulated portion of its business is closely connected with the regulated and the record makes no separation, we shall consider United Gas Corporation in the regulated category. Union is engaged in the sale of natural gas, natural gas liquids and oil. Only the sale of gas is subject to regulation. While the record would permit an allocation of Union's taxable income between its regulated and non-regulated business, arithmetically, this would make no difference because Union has a net taxable loss over the 1957-1961 period, and no part of the consolidated tax would be allocated to it whether it be classified as regulated or non-regulated. United Overseas operates entirely outside the United States and is engaged in an oil exploration project in Tunisia, North Africa, so that it is in the non-regulated category. No portion of the consolidated tax would be allocated to it in any case because it produced a loss. 13/

As shown in Appendix 5 hereto the net total consolidated tax liability for the United companies for the 1957-1961 period amounts to $57,199,881. The average for one year amounts to $11,439,976. In accordance with the Cities Service case the latter amount is allocated between United Gas Corporation and United Gas Pipe Line in proportion to their respective taxable incomes for the 1957-1961 period as shown in Appendix 5. United Gas Pipe Line's share, in accordance with this computation, amounts to $10,537,362, using the 52 percent statutory tax rate. This represents an effective tax rate of 50.04 percent based upon the five-year average. When this effective tax rate is applied to United Gas Pipe Line's test year, it results in a federal income tax allowance of $9,940,892 as shown in Appendix 4 below, subject, of course, to the rate reductions we require for the lowered tax rates in the year 1964 and again in 1965.

2. Failure to Use Liberalized Depreciation and IRS Guideline Depreciation Rates.

Memphis contends that the tax laws, regulations and procedures permit the use of liberalized depreciation and of the guideline depreciation rates of the Internal Revenue Service 14/ for determining United's income tax liability, and that the Commission in computing United's tax allowance for cost of service, should treat United as if it had availed itself of these statutory provisions, irrespective of whether the parent,

---

13/ It appears in the consolidated return only in 1961 when its loss was $24,354.

14/ Section 167 of the Internal Revenue Code and Depreciation Guidelines and Rules, I.R.S. Publication No. 456; Tables for Applying Revenue Procedure 62-21, I.R.S. Publication No. 457.

United Gas Corporation, had in fact utilized them. Memphis has failed to make a showing that the public interest requires us in this case to treat the company as though it makes use of these statutory provisions contrary to its actual practices.

3. Gas Prepayments.

The issue of the tax effect of gas prepayments presents two important questions: the effect of the prepayments on the tax allowance in the cost of service; and the effect of the accumulated prepayments on the rate base. Technically, a gas prepayment is the amount that United has been required to pay in accordance with the take or pay provisions of its gas purchase contracts in excess of payments for gas actually taken. United claims these prepayments as deductions in its tax returns for the years in which they were made. However, in computing the test year cost of service in this proceeding United has treated the prepaid gas expense as deferred charges and has not included them in computing either its tax allowances or its cost of purchase gas in its cost of service for the test period. Thus only when delivery of the prepaid gas is ultimately taken would the cost of service reflect the corresponding prepayment charges. United does, however, include an amount of $5,937,060 representing an average test year balance of prepayments in its working capital for inclusion in the rate base.

Memphis contends that this is improper; that United is entitled to and in fact takes a tax deduction for these gas prepayment charges in the years in which they arise and that it should be required to reflect these actual tax deductions in the test year period as well. On the other hand, staff and the examiner, with certain modifications, accept United's position that prepayments should not be deducted in determining the tax allowance in the cost of service. We agree with this position. Test year costs must often depart from the actual results in order to reach rates reasonable for the future. The record shows that United expected to incur deficiencies in the volumes of gas taken in 1963, but, subject to several contingencies, expected to be in balance during 1964. Beginning in the year 1965 United anticipates that it can begin to make up the deficiencies previously incurred. Whether these predictions are precisely accurate, we can conclude that the prepayments are non-recurring. Since we are determining rates prospectively, any decrease in the actual taxes in the test year will disappear in those years when the prepaid gas is actually consumed, and this promises to be in the near future. Thus a more representative tax allowance can be computed by not using the gas prepayments as deductions.

Further, we agree with the staff and the examiner that accumulated prepayments should be included in working capital. These amounts are expended in order to retain an available supply of gas and precede by several years the receipt of the related revenues to be realized when

the gas paid for in advance is made up and sold. While the record indicates that the balance of prepayments, amounting to $15,340,800 on December 1, 1962, may be reduced beginning in 1965, they represent an investment of cash on which a return should be realized for some years in the future. United would include in working capital only the average test year amount of $5,937,060 rather than the full accumulation. We think the lesser amount more representative of the future and shall employ it in computing working capital.

The examiner, following the contentions of the Eastern Intervenors, would reduce the credit to working capital for prepaid gas by the amount of taxes saved in using the prepayments as a deduction. 15/ We agree with this in principle. If United has saved taxes in making its prepayments, its investment is correspondingly reduced. However, the record indicates that although the prepayments are claimed by United as tax deductions, they may eventually be disallowed. In that case United would have no way of recovering the revenues lost as a result of reducing the credit to working capital. We will provide that United shall adjust its rates and make appropriate refunds when and if it is finally determined that the prepayments were properly deductible on its tax returns. To achieve this result with a minimum of dispute, we shall direct United to establish a special account out of earned surplus to reflect deductions taken by virtue of these prepayments.

4. Regulatory Treatment of the Investment Tax Credit.

United's cost of service presentation makes no provision or allowance for reductions in its income tax expenses attributable to the investment tax credit authorized by the Internal Revenue Act of 1962. 16/ Staff and Memphis argued that this was improper in that the investment tax credit was a tax reduction and hence an increase in United's net income. Thus they argued that, like any other tax reduction or savings, the credit must be reflected by an equivalent reduction in United's cost of service, with the result that these savings would flow through to net income and United's customers would have the benefit of the lower cost of service. As we have indicated, this issue has been rendered moot by the action of Congress prescribing that regulatory agencies shall not use such investment taxes for the purpose of establishing the company's cost of service without the consent of the company. 17/ Our cost of service shall, therefore, make no adjustments for, or otherwise give consideration to the investment tax credits which United may qualify for under the tax law.

15/ The examiner used the accumulated prepayments in the amount of $15,340,800 less 52 percent less the related income tax reductions to working capital.

16/ 26 U.S.C. § 38, 46-48.

17/ Revenue Act of 1964, Public Law 88-272, Section 203(e).

5. Tax Deductions.

The staff, and Memphis in part, have criticized the examiner for not finding that Federal and state income tax allowances should be based on (a) the more recent 1961 tax return data; (b) the five-year average of tax deductions for property abandonment losses, taxes capitalized, employee benefits capitalized and additional expenses capitalized during the years 1957-1961, inclusive, instead of the years 1956-1960, inclusive; (c) the $163,322 tax deduction for charitable contributions reflected in the 1961 return; and (d) the staff's proposed interest expense tax deduction of $10,772,145 based upon United's outstanding debt capital and actual interest rate as of November 30, 1962. In our opinion all of these factors except item (c), the charitable tax deductions, should be taken into account in computing United's tax allowance. Items (a) and (b) take advantage of more recent data available in the record, and United specifically does not object with respect to item (b), the five-year averages. Item (c), the charitable contributions, is being treated as an operating expense. As such it is automatically deducted in computing the income tax allowance since elements in the cost of service other than return are excluded from the computation. Accordingly, it should not be deducted a second time from return in completing the computation. On item (d), computation of interest as of November 30, 1962, United argues that this figure does not reflect the future in that its debt capitalization is subject to amortization and will be reduced after that date. Our purpose has been to adjust the base year ending March 31, 1962, in the light of the substantial amount of new facilities installed by United through November 30, 1962. Hence we have included in the rate base plant added up to that date. In our opinion the use of the additional plant in the rate base requires the use of the corresponding debt capitalization in the income tax computation.

COST ALLOCATION AND ZONE RATE DIFFERENTIAL

This Commission has, historically, favored rolled-in methods of allocation so that all customers will share equally in the costs of a pipeline system, unless the length of the pipeline required zone differentials. 20/ United, however, has traditionally been recognized as an exception to this principle, mainly because it has, in the past, operated two essentially separate jurisdictional systems, a line from Agua Dulce, Texas, extending northeasterly to Sterlington, Louisiana and a line from Lirette in southern Louisiana northward to central Mississippi through Jackson. But this is in the process of change as the result of the recently constructed line running from Bayou Sale in southern Louisiana to a point near Sterlington. The rates in each of these systems have in turn been subdivided into zones or rate areas where "substantially the same operating and natural conditions prevail, starting with the premise that the widest areas practicable in terms of average costs and physical characteristics of service should be designated." 21/ There have been four zones called the Southwest, Central, New Orleans, and Jackson Zones as shown on the attached map. 22/ Southwest and New Orleans are largely gas supply zones; Central and Jackson are largely gas sales zones. Thus, the problem of the allocation of United's cost of service and the formulation of just and reasonable rates is complicated by United's historical pattern of operations.

United's system of zone rate differentials has had a long history before the Commission. 23/ It was considered most lately in the Commission's order of January 4, 1961, cited. There various modifications of the allocation of costs, known as "Method 8" and previously approved by the Commission, were proposed. Under Method 8 the purchased gas costs and the transmission costs of the New Orleans Zone were computed and applied to the New Orleans Zone and carried forward and applied with additional purchased gas and transmission costs of the Jackson Zone to that zone.

20/ Trunkline Gas Co., 21 FPC 704, 711, aff'd as Battle Creek Gas Co. v. F.P.C., 281 F.2d 42 (CADC 1960); Kansas-Nebraska Natural Gas Co., 25 FPC 448, 453. See also Louisiana Public Service Commission v. United Gas Pipe Line Company, et al., 3 FPC 402, 404, 405.

21/ Louisiana Public Service Commission v. United Gas Pipe Line Company, et al., supra.

22/ The Southwest Zone included the Lafayette Zone now proposed by United.

23/ See United Gas Pipe Line Co., 3 FPC 402; 13 FPC 396; 14 FPC 353, 406, aff'd as to allocation Mississippi River Fuel Corp. v. F.P.C., 252 F.2d 619 (CADC 1957), cert. den. 355 U.S. 904; 25 FPC 26, January 4, 1961.

Likewise, the costs of the Southwest Zone were applied to that zone and carried forward to the Central Zone and added to the costs of that zone. The effect of this was to permit the Southwest Zone customers in Texas, as well as the Central Zone customers, to benefit from the lower producers prices of that zone. On the other hand the New Orleans Zone and Jackson Zone customers would be subject to the higher gas prices in Louisiana.

The Commission justified Method 8 in its January 4, 1961, order (25 FPC at p. 31) on the ground that United's system was, in fact, two separate systems with smaller interconnecting facilities. That is one system ran north from southern Louisiana and the other ran northeast from southern Texas. It also pointed out that the daily take from Texas sources was greater than necessary to serve all nonjurisdictional Texas customers, and that the direction of the gas flow on the Texas part of the system was away from the Southwest Zone and into the Central Zone. Likewise the flow from southern Louisiana sources was to nonjurisdictional customers in Louisiana and north into the Jackson Zone. The Commission noted it would take a major shutdown and flow reversal to cause any substantial flow of southern Louisiana gas into the Southwest or Central Zones.

As the examiner finds, there is a change in this pattern of operation today. The record shows that a large net flow still exists from the Southwest Zone to the Central Zone on the Agua Dulce and smaller lines and from the New Orleans to the Jackson Zone. However, it is now estimated that gas approximately equal to the other Southwest volumes would flow from the eastern part of the Southwest Zone, proposed to be called the Lafayette Zone, into the Central Zone on the new 30-inch pipeline during 1963 and that with additional capacity this flow would be greatly increased in the 1963-1964 heating season. There is also estimated a heavy flow from Bayou Sale in the New Orleans Zone into the proposed Lafayette Zone on the new 30-inch interconnection, and there is a relatively small flow (that has existed from 1950) from the Jackson Zone into the Central Zone on an 18-inch line. The record shows that the flow in the new 30-inch line from southern Louisiana into the Central Zone at Sterlington is to meet deficiencies in the supply of gas to the Central Zone customers and is an essential part of United's operations.

In the light of these developments a number of methods for allocating United's costs were proposed by various parties to the proceeding. United itself proposed a variant of Method 8 by establishing the separate Lafayette Zone shown on the map in Appendix 1 hereto, which was formerly a part of the Southwest Zone. United points out that gas flows from the New Orleans Zone to the proposed Lafayette Zone and, together with additional volumes contributed by the Lafayette Zone, is transported on the new 30-inch line up to the Central Zone. Alternatively on rebuttal United merged the Lafayette and New Orleans Zones, thus in effect transferring what was Southwest Zone territory to the New Orleans Zone. As a further alternative United would combine the Central and Jackson Zones. We agree with the examiner that the establishment of a new zone or the

shifting of territory is not justified at this stage in the development of the system, which is becoming more unified and will call for more departures from Method 8 in the future as indicated below.

The staff, on the other hand, departed from Method 8. It allocated purchased gas costs directly to those of United's nonjurisdictional sales in the New Orleans and Southwest Zones that were made from facilities that were considered to be intrastate and physically separate from United's interstate system. The staff then rolled-in jurisdictional purchased gas costs on a system-wide basis. Adjustments were then made to give effect to the lower cost of sales in the New Orleans Zone and the lower cost of transportation in the Central Zone.

While we favor rolled-in methods of allocation, in our opinion the United system has not yet developed to this stage. Any rates established in line with such a rolled-in allocation would be too disruptive of business relationships in view of the historical patterns. Therefore we do not approve at this time of the staff's proposed roll-in of costs, but we expect that future allocations of United's costs will trend in the direction of a complete roll-in. However, we find that the staff's method of separating the purchased gas costs of nonjurisdictional sales made from intrastate facilities in the New Orleans Zone and in the Southwest Zone (including the proposed Lafayette Zone) was appropriate, and we have carried out that separation as shown in Appendix 6 hereto. As can be seen, almost all of the nonjurisdictional sales in the New Orleans Zone are subject to the direct assignment of purchased gas costs, and the greater part of those in the Southwest Zone are also treated in this way. We think it a desirable principle of rate making that costs should be directly assigned whenever feasible, and cost allocation with all of its complexities should be employed only when necessary. As witness for the Eastern Interveners testified, jurisdictional customers should not be burdened by the costs of nonjurisdictional purchases which are not subject to regulation by the Commission.

United objects to this separation of purchased gas costs contending that the intrastate facilities from which these nonjurisdictional sales are made are not, in fact, separable (at least in the Southwest Zone), and, further, that it is inequitable to make a separation of purchased gas costs without at the same time making a separation of transmission costs. The record shows the intrastate facilities in the New Orleans Zone are entirely separate; the books are separate; and operations are carried on in partnership with another company. In the Southwest Zone the separation is less simple. It appears that a relatively small amount of gas sold under rate schedules on file with the Commission is necessary in addition to the gas from unfiled rate schedules to make the full amount of sales from the facilities designated by the staff as intrastate. Furthermore, some of the

separated sales of intrastate gas in Texas are made from facilities that may carry interstate gas. In spite of these possible qualifications, in our opinion, the staff made a reasonable separation of facilities and sales in the Southwest Zone that largely reflects the company's operations and is a closer approximation to reality than conventional allocation. With respect to transmission costs we would assign these directly as well as the purchased gas costs, but on the record the transmission costs are not separable so as to permit their direct assignment.

Memphis asks that the Southwest Zone be expanded to include low priced gas from Eugene Island to the Bayou Sale Junction. This represents a further attempt to reserve certain gas supplies for certain customers and is inconsistent with the development of the system. In any case the need is obviated by the examiner's solution to the allocation problem discussed below, particularly the roll-in of the Central and Jackson Zones.

Interveners, Texas Gas, Mississippi River Fuel and UGI urge the retention of Method 8 on the ground that there is no reason to deviate from a method used in the past. We think that the operation of the new 30-inch line basically changes the operation of the system, and the method of allocation must accordingly be changed.

In the light of the contentions of the parties the examiner arrived at a method of allocation and adjustment of the rate levels that reflects the historical pattern of rates in the past yet gives effect to the changes that have occurred. The examiner would retain the separation of the present Southwest and New Orleans Zones. While he would not make the direct assignment of purchased gas costs to intrastate sales as prescribed here, he would determine costs separately for the two southern zones and carry the costs forward to the two northern zones, Central and Jackson, and he would roll-in the purchased gas costs for these two zones. This properly reflects the fact that the Central Zone is receiving large amounts of gas from the New Orleans Zone via the new line and will receive larger amounts in the future. 24/ We shall adopt the examiner's roll-in of the two northern zones

---

24/ A large part of this New Orleans Zone gas is low priced gas from Eugene Island through Bayou Sale, but some gas does come south to the junction point at Bayou Sale from Duck Lake. At any rate the low priced gas formerly went into the Jackson Zone and presumably is only available to the Central customers because the Jackson customers take larger amounts of other New Orleans Zone gas.

as a logical outcome of the development of United's system. We shall extend this allocation to transmission costs as well as purchased gas costs, because the two northern zones are both becoming dependent on the producing regions of both southern zones. In performing the allocation we think that the two zones should be rolled-in before an allocation is made to jurisdictional and nonjurisdictional customers since it is our intention to treat the two northern zones as one.

While strictly a matter of rate design, the examiner's treatment of the rate levels in the Central and Jackson Zones should be considered in connection with his method of allocation. He found, we think with ample justification, that a differential between the two zones was necessary, for a roll-in of purchased gas costs with no price differential would increase the Central Zone rates by some six million dollars a year. In order to avoid this disruptive result he adopts a price differential of 3.5 cents in the commodity component of the rate to give weight to both cost and historical considerations. Furthermore, in order not to make a sudden change in prevailing rate patterns, he would leave the presently effective Central Zone rates in effect and apply all decreases in the cost of service, including reductions in purchased gas cost, to the Jackson rates until the 3.5-cent price differential is reached. We will adopt his differential between the zones, which, in our judgment is appropriate although we are aware that certain of the interveners contend it is too much and others contend it is too little. However, we do not adopt the examiner's conclusion that the presently effective Central Zone rates should remain in effect, and that the 3.5-cent differential should be reached only as a result of reductions in the cost of service. The amount of such reductions is unknown, and we think that a definite differential should now be put into effect representing a reduction in the present differential between the zones.

In our opinion the 3.5-cent differential represents a reasonable step in this transition period toward a more complete roll-in of United's costs. We note, furthermore, that the differential was around 3 cents in accordance with the Commission's approval of settlement rates in 1954, 25/ but later filings have shown higher differentials ranging up to 8.00 cents per Mcf. More recently, however, these differentials have shown a tendency to decrease, reaching 5.76 cents in United's filing of substitute rates in RP63-1. Of course, settlement rates and filed rates are not evidence of what rates should be or differentials should be, but do indicate economic trends. The record here shows that the differential increased in response to the flow of higher priced southern Louisiana gas to the Jackson Zone, and decreased more recently because of the flow of southern Louisiana gas to the Central Zone and because of the tendency of gas prices to level off.

In conclusion we believe adoption of the examiner's approach as reflected in Appendices 2 and 6 attached gives weight to the methods of allocation used by us in the past, and to the changing pattern of operations. There is nothing to show that it will cause loss of United's nonjurisdictional business in Texas or will upset customer relationships in the two northern zones. It is to be understood that it is not the final word in the allocation of United's costs. In a future proceeding the United system may be found to be even more an integrated network than it is now. At that time a more complete roll-in of costs may be appropriate. As oft said, "The problem is to allocate to each class of the business its fair share of the costs. * * * Allocation of costs is not a matter for the slide rule. It involves judgment on a myriad of facts. It has no claim to an exact science." Colorado Interstate Co. v. F.P.C., 324 U.S. 581, 588.

25/ United Gas Pipe Line, 13 FPC 398, 406.

UNITED GAS PIPE LINE COMPANY, Docket No. RP63-1

Computation of Federal and State Income Tax Allowances
Related to Estimated 1963 Sales

Description (1)	Tax Calculation (2)	Reduction of Working Capital for Federal Income Tax (3)	Return and Tax (4)
Rate Base			
Net plant	$364,855,025		$364,855,0
Working capital	13,610,537	(4,971,089)	8,639,4
Total	$378,465,562	(4,971,089)	$373,494,4
Return at 6.5%	24,600,261		24,277,2
Less .484137D 1/			
.484137 x $14,350,856	6,947,780		
	17,652,481		
Return and tax $17,652,481 ÷ .515863 2/	$ 34,219,320		
Computation of Federal income tax:			
Return and tax	$ 34,219,320		
Less tax deductions	14,350,856		
Taxable income	19,868,464		
Tax at 50.04%	9,942,179		9,942,1
			$ 34,219,3
50% of federal income tax as source of working capital	$ 4,971,089		
Computation of State income tax:			
Taxable income	$ 19,868,464		
Tax at 1.794%	$ 356,520		

1/ Derivation of .484137D: .5004D less [(.065) (.50) (.5004)]

2/ Derivation of .515863: 1.000000 less .484137

UNITED GAS PIPE LINE COMPANY, Docket No. RP63-1

Computation of Consolidated Effective Tax Rate

	Year 1957	Year 1958	Year 1959	Year 1960	Year 1961	Total	Percentage to Total
Consolidated taxable income, Exh. 36 Revised	$26,089,321	$30,955,531	$21,924,598	$15,936,714	$15,515,010	$110,421,174	
Deduct long-term capital gain	- 0 -	- 0 -	73,688	60,035	234,798	368,519	
Balance	26,089,321	30,955,531	21,850,910	15,876,679	15,280,214	110,052,655	
Tax at 52%	13,566,447	16,096,876	11,362,473	8,255,873	7,945,721	57,227,381	
Less surtax exemption	5,500	5,500	5,500	5,500	5,500	27,500	
Adjusted Consolidated Tax	$13,560,947	$16,091,376	$11,356,973	$ 8,250,373	$ 7,940,211	$ 57,199,881	
Taxable Income, United Gas Corp., Exh. 36 Revised	$ 2,743,517	$ 3,528,821	$ 2,939,594	$ 2,700,979	$(2,888,741)	$ 9,024,170	7.89
Taxable Income, United Gas Pipe Line Company, Exhibit 36 Revised	22,615,772	22,573,974	20,943,401	17,569,439	18,588,390	105,290,983	92.11
Total						$114,315,153	100.00
Percentage of United Gas Pipe Line to total						92.11%	
Consolidated tax for years 1957 - 1961						$ 57,199,881	
Average consolidated tax $57,199,881 ÷ 5 years						$ 11,439,976	
Portion of tax applicable to United Gas Pipe Line Co. $11,439,976 x 92.11%						$ 10,537,362	
Average taxable income of United Gas Pipe Line Co. $105,290,983 ÷ 5 years						$ 21,058,197	
Consolidated effective tax rate, $10,537,362 ÷ $21,058,197						50.04%	

United Gas Pipe Line Company
Jurisdictional Cost of Service
Related to Estimated 1963 Sales

Description	Total	Combined Central-Jackson Zone	Northwest Mississippi Zone	Southwest Zone	New Orleans Zone
Jurisdictional Cost of Service					
Production System					
Pipeline	$ 235,495	$ 235,495	$ -	$ -	$ -
Town Border	10,568	10,568	-	-	-
Total Production System	246,063	246,063	-	-	-
Transmission System					
Pipeline	116,258,106	111,698,072	-	4,560,034	-
Town Border	27,276,481	23,080,255	1,025,286	3,170,940	-
Total Transmission	143,534,587	134,778,327	1,025,286	7,730,974	-
Total Jurisdictional Sales	143,780,650	135,024,390	1,025,286	7,730,974	-
Tariff Transportation	1,857,118	1,857,118	-	-	-
Total Jurisdictional Service	145,637,768	136,881,508	1,025,286	7,730,974	-
Non-Jurisdictional Service	180,418,735	49,864,122	-	89,114,358	41,440,255
Total Cost of Service	$326,056,503	$186,745,630	$1,025,286	$96,845,332	$41,440,255

Only brief mention need be made of the issue concerning the consolidated tax question. The majority continues to defy the precise intent of Congress in granting the privilege of the consolidated return to an affiliated group of corporations. The law has wisely refrained from imposing a statutory requirement of assigning or distributing consolidated tax liability among members of the affiliated group. Hence a method of allocation adopted for the intersé purpose of the group is solely an internal affair. Each affiliate, including the parent, should accrue its tax liability as if its returns were filed on a separate basis. The reasons given in my dissenting opinion in the Cities Service case 20/ are equally applicable here and I so intend them to be.

20/ Cities Service Gas Company, Docket No. G-18799, Opinion No. 396 and accompanying Order, issued July 15, 1963.

[fol. 56] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Nos. 21872 and 21958

UNITED GAS PIPE LINE Co., Petitioner,

v.

FEDERAL POWER COMMISSION, Respondent.

PETITIONS FOR REVIEW OF ORDER OF THE FEDERAL POWER COMMISSION

ORDER DENYING PETITIONER'S APPLICATION FOR STAY—October 21, 1964

Before RIVES and WISDOM, Circuit Judges, and MORGAN, District Judge.

PER CURIAM:

The petitioner's application for stay of the order of the Federal Power Commission is DENIED.

[fol. 57] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 21872

UNITED GAS PIPE LINE COMPANY, Petitioner,

vs.

FEDERAL POWER COMMISSION, Respondent.

No. 21958

UNITED GAS PIPE LINE COMPANY, Petitioner,

vs.

FEDERAL POWER COMMISSION, Respondent.

MOTION OF PETITIONER FOR LEAVE AND PERMISSION TO WITHDRAW AND ABANDON CERTAIN ISSUES—Filed February 9, 1965.

To The Honorable, The Judges of the United States Court of Appeals for the Fifth Circuit:

Petitioner, United Gas Pipe Line Company (United) herewith applies to this Honorable Court for leave and permission to withdraw and abandon certain issues below described, and to restrict the issues to be heard to that below described, and that as to such issues withdrawn and abandoned such review proceedings to that extent be dismissed, and for grounds shows:

1

In October of 1964 following perfection of the above appeals in this Honorable Court, a number of United's [fol. 58] customers requested United to consider whether it might be possible to settle and dispose of all of United's rate proceedings then pending before the Federal Power Commission (FPC). For this Court's information, these involved certain issues reserved in a prior proceeding identified on the FPC Docket as RP61-18; the proceedings, orders and opinions in Docket RP63-1, which gave rise to the above appeals; and a subsequent rate increase proceeding

docketed at RP65-1, then in its preliminary stages on the Commission docket.

United, after consideration, made a proposal to its customers.

2

United's proposal to its customers led to conferences with the Staff of the Commission and all parties, which resulted in a settlement of all issues save and except the issue involving the use by the Commission of a consolidated effective tax rate, rather then the use of the applicable federal statutory corporate income tax rate in computing the federal income tax allowance in United's jurisdictional cost of service, an issue identified by all parties as the "consolidated effective tax rate issue." Being unable to reach agreement for disposition of such tax issue, the [fol. 59] Settlement Agreement excepted and excluded it from the settlement, and provided that such tax issue should be processed to final decision and judgment in these review proceedings. The Settlement Agreement required United, subject to Commission approval of the Settlement, to withdraw and seek dismissal of all issues reserved and tendered by United in its Motions for Rehearing and in the two above numbered appeals, except the consolidated effective tax rate issue.

This Honorable Court will find error assigned to the Commission's use of a consolidated effective tax rate, rather than the use of the applicable federal statutory corporate income tax rate in computing the federal income tax allowance in United's jurisdictional cost of service on pages 9 and 10 of the Petition for Review in No. 21872, and on pages 10 and 11 of the Petition for Review in No. 21958, above, the error being reserved by paragraph 3 of the Motions for Rehearing attached to each Petition for Review.

3

On December 23, 1964, the Commission issued its order approving the Settlement Agreement and approving the [fol. 60] provisions of that Agreement excepting and reserving for decision the consolidated effective tax rate issue posed as above described. This order became final on January 25, 1965.

To implement the Settlement Agreement so approved by the Commission order aforesaid, United files this application for permission to withdraw all issues in the two above numbered dockets, save and except the consolidated effective tax rate issue, and for an order dismissing such withdrawn issues. In this connection United shows that this Court has approved a briefing schedule which will continue to be applicable to and govern the filing of briefs upon such consolidated effective tax rate issue.

WHEREFORE, premises considered, United herewith applies to this Honorable Court for permission to withdraw the two above captioned appeals as to all issues involved therein *save and except* the issue involving the use by the Commission of a consolidated effective tax rather than the applicable federal statutory corporate income tax rate in computing the federal income tax allowance in United's jurisdictional cost of service, and for an order dismissing [fol. 61] such withdrawn issues, that the briefing schedule heretofore approved by this Court continue to control the preparation and filing of briefs upon the consolidated effective tax rate issue, and that this application be taken and deemed to be all action needed to accomplish such withdrawal and dismissal and the preservation of the excepted issue for decision, subject to approval by this Honorable Court.

United Gas Pipe Line Company, By /s/ Thomas Fletcher, 2025 First City National Bank Bldg., Houston, Texas—77002, Its Attorney of Record.

ORDER

Upon consideration of the foregoing Application, it is ORDERED that the above and foregoing review proceedings be and they are hereby dismissed as to all issues reserved and tendered save and except the issue involving the use by the Commission of a consolidated effective tax rate [fol. 62] rather than the applicable federal statutory corporate income tax rate in computing the federal income tax allowance in Petitioner's jurisdictional cost of service, and that the approved briefing schedule control the briefing of such reserved tax issue.

[fol. 63] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 22041

TEXAS EASTERN TRANSMISSION CORPORATION, Petitioner,

v.

FEDERAL POWER COMMISSION, Respondent.

MOTION OF TEXAS EASTERN TRANSMISSION CORPORATION TO WITHDRAW APPEAL EXCEPT AS TO PARTICULAR ISSUES, TO SEVER RETENTION OF REFUND ISSUE AND TO POSTPONE PROCEEDINGS AS TO SEVERED ISSUE—filed February 9, 1965.

To The Honorable Judges of the United States Court of Appeals For the Fifth Circuit:

COMES Now Texas Eastern Transmission Corporation (Texas Eastern) and files this Motion to Withdraw Appeal Except as to Particular Issues, To Sever Retention of Refund Issue and to Postpone Proceedings as to Severed Issue, and as grounds therefor respectfully represents to the Court:

[fol. 64] 1

Motion to Withdraw Appeal Except as to Particular Issues

Texas Eastern moves the Court to permit the withdrawal of its above-captioned appeal except as such appeal relates to the issues of (1) the use by the Commission of a consolidated effective tax rate in computing the Federal Income Tax Allowance in the jurisdictional cost-of-service of United Gas Pipe Line Company (United)[1] and (2) the Commission's ordering United to hold and retain, pending further Commission order, amounts which United's jurisdictional customers contend they are entitled to receive as refunds.[2]

---

[1] Assignment of Error (1) in Petition for Review.

[2] Assignment of Error (6) in Petition for Review.

As a jurisdictional pipeline customer of United, Texas Eastern filed its petition to review Opinion Nos. 428, 428-A and 428-B and accompanying orders issued by the Respondent, Federal Power Commission, in connection with a rate increase filed by United in Docket No. RP63-1.[3] Since [fol. 65] the filing of the appeal, United, its customers (including Texas Eastern), and the Commission Staff have agreed to a settlement of various issues in United's Docket No. RP63-1 as well as a settlement of issues in rate increase proceedings filed by United in Docket Nos. RP-61-18 and RP65-1. This settlement agreement disposed of all of the issues in the pending appeals filed in this Court by Texas Eastern, United, and the other pipelines with respect to the Commission's orders in United's Docket No. RP63-1 except the two issues enumerated above. By order issued December 23, 1964, the Respondent, Federal Power Commission, approved the settlement agreement and ordered the appeals to be withdrawn except insofar as they relate to the two issues reserved by the settlement agreement. Texas Eastern therefore requests permission to withdraw its appeal except as it relates to the two abovementioned issues.

2

Motion to Sever Retention of Refund Issue and to Postpone Proceedings as to Severed Issue.

Texas Eastern further moves the Court to sever the refund retention issue [Assignment of Error (6)] from the consolidated [fol. 66] tax issue [Assignment of Error(1)] and to postpone the filing of briefs and other proceedings[4] with respect to said refund retention issue.

In its order of December 23, 1964, approving the afore-

[3] Appeals of the same orders of the Commission were filed in this Court by United (Nos. 21872 and 21958), Natural Gas Pipeline Company of America (No. 22031), and Texas Gas Transmission Corporation (No. 22039).

[4] Pursuant to order issued by this Court, procedures were agreed upon for the filing of briefs, the joint appendix, etc. under which the initial briefs to be filed by Texas Eastern and the other pipeline petitioners are due March 8, 1965.

mentioned settlement in United's Docket Nos. RP61-18, RP63-1 and RP65-1 the Commission, as in its prior orders in Docket No. RP63-1, ordered United to hold and retain, pending further order of the Commission, certain refunds which Texas Eastern contends it is legally and equitably entitled to receive now. In accordance with Section 1.34 of the Commission's Rules of Practice and Procedure and Section 19(a) of the Natural Gas Act, Texas Eastern has filed an Application for Rehearing of the Commission's order of December 23, 1964,[5] insofar as it directs United to hold and retain certain refunds due Texas Eastern pending further order of the Commission.

This Application for Rehearing urges, *inter alia*, the same errors as to the Commission ordering the retention of refunds by United as are urged in Texas Eastern's pending [fol. 67] appeal in No. 22041 [Assignment of Error (6)]. The Application for Rehearing is presently pending before the Commission. If it is granted the refund issue in Texas Eastern's pending appeal will be rendered moot. If the Application for Rehearing is denied, Texas Eastern intends to file a petition for review in this Court which will necessarily duplicate in large part its present appeal in No. 22041 insofar as the retention of refunds by United is concerned.

Therefore, if Texas Eastern's pending Application for Rehearing is granted the severance and postponement proposed herein will avoid burdening the Court and the parties with lengthy briefs, arguments, etc. related to an issue which will be moot. On the other hand if the pending Application for Rehearing is denied, the procedure proposed by Texas Eastern will avoid the duplication of briefs, arguments, etc. which would result if the refund retention issue raised in Texas Eastern's present appeal in No. 22041 is heard separately from its appeal of the Commission's order of December 23, 1964, in Docket Nos. RP61-18, RP63-1 and RP65-1.

---

[5] The Application for Rehearing also complains of the Commission's order issued December 31, 1964, denying Texas Eastern's telegraphic objections to the provisions of the December 23, 1964, order as required by ordering paragraph (K) thereof.

[fol. 68] Texas Eastern proposes to proceed with its appeal of the consolidated income tax issue in accordance with the procedures previously agreed upon and ordered by this Court and to file its initial brief on such issue with the Court in accordance with the stipulations of the parties and the orders of this Court.

Texas Eastern is authorized to inform the Court that the Respondent, Federal Power Commission, has no objection to the granting of this motion.

Wherefore, Petitioner Texas Eastern Transmission Corporation respectfully prays that the Court enter an order:

(1) Permitting Texas Eastern to withdraw and dismiss its appeal in No. 22041 except as such appeal relates to the consolidated tax issue and the refund retention issue as detailed above;

(2) Severing the refund retention issue from the consolidated tax issue and postponing proceedings with respect to such refund retention issue pending further proceedings in connection with Texas Eastern's Application for Rehearing of the Commission's order [fol. 69] issued December 23, 1964 in Docket Nos. RP61-18, RP63-1 and RP65-1; and

(3) Granting Texas Eastern such other and further relief as may to the court appear to be just and equitable.

Respectfully submitted, /s/ David T. Searls, J. Evans Attwell, Vinson, Elkins, Weems & Searls, 2100 First City National Bank Building, Houston, Texas. 77002. Jack D. Head, P. O. Box 2521, Houston, Texas. 77001. Keith M. Pyburn, 425 13th Street, N. W., Washington, D. C., Attorneys for Petitioner, Texas Eastern Transmission Corporation.

Dated at Houston, Texas, this 8th day of February, 1965.

[fol. 70] Certificate of Service Omitted in printing.

[fol. 71] [File endorsement omitted.]

[fol. 72] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 22031

NATURAL GAS PIPELINE COMPANY OF AMERICA, Petitioner,

v.

FEDERAL POWER COMMISSION, Respondent.

MOTION OF NATURAL GAS PIPELINE COMPANY OF AMERICA TO WITHDRAW APPEAL EXCEPT AS TO PARTICULAR ISSUES, TO SEVER RETENTION OF REFUND ISSUE AND TO POSTPONE PROCEEDINGS AS TO SEVERED ISSUE—filed February 12, 1965.

To The Honorable Judges of the United States Court of Appeals For the Fifth Circuit:

Natural Gas Pipeline Company of America (Natural) hereby moves that the first four "Grounds For Review" in Natural's "Petition For Review" herein be withdrawn, that its appeal herein be maintained as to the fifth and sixth grounds therein, but that the sixth ground be severed from the fifth ground and that the schedule for the filing of briefs and other proceedings with respect to such sixth ground be postponed. In support thereof, Natural states:

[fol. 73] I. Motion to Withdraw the First Four Grounds of Appeal

Natural moves this Court to permit the withdrawal of its above-captioned appeal except as such appeal relates to the issues of (1) the use by the Commission of a consolidated effective tax rate rather than the applicable statutory tax rate in computing the Federal Income Tax Allowance in the jurisdictional cost of service of United Gas Pipe Line Company (United)* and (2) the Commission's ordering United to hold and retain refunds of amounts

* Assignment of Error (5) in Natural's Petition for Review.

which United's jurisdictional customers contend they are entitled to receive.**

As a jurisdictional pipeline customer of United, Natural filed its petition to review Opinion Nos. 428 and 428-A and accompanying orders issued by the Respondent, Federal Power Commission, relative to an application for rate increase filed by United in Docket No. RP63-1. Since the filing of the appeal, United, its customers (including Natural), and the Commission Staff have agreed to a settlement of various issues in United's Docket No. RP63-1 as well as a settlement of issues in rate increase proceedings filed by United in Docket Nos. RP61-18 and RP65-1. This settlement agreement disposed of all of the issues in the pending appeals filed in this Court by Natural, United, and the other pipelines with respect to the Commission's orders [fol. 74] in United's Docket No. RP63-1 except the two issues enumerated above. By order issued December 23, 1964, the Respondent, Federal Power Commission, approved the settlement agreement and ordered the appeals to be withdrawn except insofar as they relate to the two issues reserved by the settlement agreement. Natural therefore requests permission to withdraw the first four Grounds of Review in its Petition for Review herein, each of which relate to cost allocation, rate zone and rate design issues, each of which issues was settled by the above proceedings.

II. Motion to Sever Natural's Ground Number 6 for Review from Ground Number 5 and to Postpone Proceedings as to Ground Number 6

Natural further moves this Court to sever the issue of the Commission's attempts to order United to hold refunds due to its customers (Ground for Review Number 6) from the issue of rate treatment of "consolidated taxes" (Ground for Review Number 5) and to postpone the filing of briefs *** and other proceedings with respect to the refund retention issue.

** Assignment of Error (6) in Natural's Petition for Review.

*** Briefs of Natural and other petitioners are due on March 8, 1965.

In its order of December 23, 1965, approving the aforementioned settlement in United's Docket Nos. RP61-18, RP63-1 and RP65-1 the Commission, as in its prior orders in Docket No. RP63-1 ordered United to hold and retain, pending further order of the Commission, certain refunds [fol. 75] which Natural contends are legally and equitably due to United's customers. In accordance with Section 1.34 of the Commission's Rules of Practice and Procedure and Section 19(a) of the Natural Gas Act, Texas Eastern Gas Transmission Company has filed an Application for Rehearing of the Commission's order of December 23, 1964, insofar as it directs United to hold and retain certain refunds due Texas Eastern pending further order of the Commission.

That Application for Rehearing urges, *inter alia*, basically the same errors relative to the Commission ordering the retention of refunds by United as are urged in Natural's pending appeal in No. 22031 (Assignment of Error (6)). Texas Eastern's Application for Rehearing is presently pending before the Commission. If it is granted the refund issue in the pending appeals of Texas Eastern and Natural will be rendered moot. If the Application for Rehearing is denied, Texas Eastern has stated that it intends to file a petition for review in this Court which will necessarily duplicate in large part its present appeal in No. 22041, insofar as the retention of refunds by United is concerned, and Natural's Ground for Appeal Number 6.

Therefore, if Texas Eastern's pending Application for Rehearing is granted, the severance and postponement proposed herein will avoid burdening the Court and the parties with lengthy briefs, arguments, etc. related to an issue which will be moot. On the other hand if the pending Application for Rehearing is denied, the procedure pro- [fol. 76] posed by Natural herein will avoid the duplication of briefs, arguments, etc. which would result if the refund retention issue raised in the present appeals of Natural and Texas Eastern proceed now so that they are heard prior to the appeal of Texas Eastern from such denial.

Natural proposes to proceed with its appeal of the consolidated income tax issue in accordance with the procedures previously agreed upon and ordered by this Court and to file its initial brief on such issue with the Court in ac-

cordance with the heretofore filed stipulations of the parties and the orders of this Court.

Natural is authorized to inform the Court that the Respondent, Federal Power Commission, has no objection to the granting of this motion.

WHEREFORE Petitioner respectfully prays that this Court enter an order:

(1) Permitting Natural to withdraw and dismiss its appeal in No. 22031 except as such appeal relates to the consolidated tax issue and the refund retention issue as detailed above;

(2) Severing the refund retention issue from the consolidated tax issue and postponing proceedings with respect to such refund retention issue pending further proceedings in connection with Texas Eastern's Application for Rehearing of the Commission's order issued December 23, 1964 in Docket Nos. RP61-18, RP63-1 and RP65-1; and

[fol. 77] (3) Granting Natural such other and further relief as may to the Court appear to be just and equitable.

Respectfully submitted, /s/ William W. Brackett, Charles C. McDugald, William W. Brackett, Ross, Hardies, O'Keefe, Babcock, McDugald & Parsons Room 1900, 122 South Michigan Avenue, Chicago, Illinois 60603, Attorneys for Petitioner, Natural Gas Pipeline Company of America.

February 10, 1965.

[fol. 78] [File endorsement omitted]

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 21872

UNITED GAS PIPE LINE COMPANY, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 21958

UNITED GAS PIPE LINE COMPANY, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 22031

NATURAL GAS PIPE LINE COMPANY OF AMERICA, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

[fol. 79] No. 22039

TEXAS GAS TRANSMISSION CORPORATION, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 22041

TEXAS EASTERN TRANSMISSION CORPORATION, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL POWER COMMISSION

ORDER GRANTING MOTIONS—Filed March 3, 1965

Before TUTTLE, Chief Judge, and BROWN and FRIENDLY*, Circuit Judges.

---

* Of the Second Circuit, sitting by designation.

By the Court:—

It Is Ordered that the Motion of Petitioner in Case Nos. 21872 and 21958 for leave to withdraw and abandon certain issues in said causes be, and the same is hereby Granted;

It Is Further Ordered that the Motions of Petitioners in Case Nos. 22031 and 22041 to withdraw appeal except as to particular issues, to sever retention of refund issue, and to postpone proceedings as to severed issue in said causes be, and the same are hereby Granted;

[fol. 80] It Is Further Ordered that the Motion of Petitioner in Case No. 22039 to withdraw its Petition for Review be, and the same is hereby Granted; and

It Is Further Ordered that the Motion of Intervenor, Willmut Gas and Oil Company, for leave to withdraw as Intervenor in Case Nos. 21872, 21958, 22039 and 22041 be, and the same is hereby Granted.

[fol. 81] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 21872

UNITED GAS PIPE LINE COMPANY, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 21958

UNITED GAS PIPE LINE COMPANY, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 22031

NATURAL GAS PIPE LINE COMPANY OF AMERICA, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 22041

TEXAS EASTERN TRANSMISSION CORPORATION, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

[fol. 82] Petitions for Review of Orders of the Federal Power Commission

OPINION—February 10, 1966.

Before JONES, WISDOM and GEWIN, Circuit Judges.

PER CURIAM: Before the Court for its consideration are four petitions for review of orders of the Federal Power Commission which present the same rather narrow but difficult question for determination. The Petitioner United Gas Pipe Line Company is a natural gas transmission company. It is a member of an affiliated group which files consolidated Federal income tax returns, and its income is included in the consolidated returns. If United had not joined in the filing of consolidated returns, but had filed re-

turns only reporting its income for tax computation, its net taxable income would have been fixed at a 52% rate. Because another of the affiliated companies, which is not subject to Federal Power Commission jurisdiction, sustained losses, the tax rate for the consolidated group is less than 52%.[1] United claimed that in fixing its rates, the Commission should allow as a part of cost of service the amount of income tax which it would have paid if it had filed a separate income tax return. The Commission disagreed. It allocated the tax differential between the 52% rate and the rate paid on the consolidated return, and allowed what it called an effective tax rate. The reasoning and conclusions of the Commission in *Re Cities Service Gas Co.*, 30 F.P.C. 158, 49 P.U.R. 3d 229, were followed by the [fol. 83] Commission. The Commission, with two of the Commissioners dissenting, rejected the contention of United. *Re United Gas Pipe Line Company*, ... F.P.C. . . . ., 54 P.U.R. 3d 285.[2] United has petitioned for a review of the Commission's order. Texas Gas Transmission Corporation and Texas Eastern Transmission Corporation, who are customers of United and intervenors in the proceeding before the Commission, have also petitioned for review, aligning themselves with United.[3]

The Court of Appeals for the Tenth Circuit vacated the Commission's order in the *Cities Service* case. *Cities Service Gas Co.* v. *Federal Power Commission*, 10th Cir. 1964, 337 F.2d 97. United would have us follow the Tenth Circuit's *Cities Service* decision. The Commission says that the *Cities Service* case is to be distinguished because of

---

[1] The 52% corporate tax rate referred to here and elsewhere is not strictly accurate as the first $25,000 of corporate income is taxed at a 22% rate.

[2] Subsequent rulings of the Commission, ... F.P.C. . . . ., 55 P.U.R. 3d 483, ... F.P.C. . . . ., 55 P.U.R. 3d 499, on rehearings do not affect its ruling on the issue before the Court.

[3] The Commission has suggested that these intervenors are not aggrieved by the order and hence have no standing to seek a review of the order. The Court's disposition of the cause makes unnecessary a determination of this question.

fact differences. It urges that the Tenth Circuit decision is wrong and should not be followed. We do not think there are any such fact differences between *Cities Service* and this case as call for the application of any different rule of decision. The Court in the Tenth Circuit case held that the tax allocation as made by the Commission's order was contrary to the requirements which Congress had imposed. We think the Tenth Circuit case is correct and that the principles which are announced in its opinion are here applicable and controlling. The Commission's order, using an incorrect [fol. 84] income tax rate in computing cost of service for the fixing of United's gas rates is erroneous and must be

VACATED AND SET ASIDE.

[fol. 85] IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1965

D. C. No. RP63-1

No. 21872

UNITED GAS PIPE LINE COMPANY, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 21958

UNITED GAS PIPE LINE COMPANY, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 22031

NATURAL GAS PIPE LINE COMPANY OF AMERICA, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

No. 22041

TEXAS EASTERN TRANSMISSION CORPORATION, Petitioner,

versus

FEDERAL POWER COMMISSION, Respondent.

[fol. 86] Petitions for Review of Orders of the Federal Power Commission

Before JONES, WISDOM and GEWIN, Circuit Judges.

JUDGMENT—February 10, 1966

This cause came to be heard on the petitions of United Gas Pipe Line Company, Natural Gas Pipe Line Company of America and Texas Eastern Transmission Corporation, for review of Orders of the Federal Power Commission, on the consolidated tax issue, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the Order of the

Federal Power Commission in this cause be, and the same is hereby vacated and set aside in accordance with the opinion of this Court.

Issued as Mandate: Mar. 7, 1966.

[fol. 87] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 88] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1965

No. 1301

FEDERAL POWER COMMISSION, Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, ET AL.

ORDER ALLOWING CERTIORARI—June 13, 1966

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted. The case is consolidated with No. 1302 and a total of two hours is allotted for oral argument.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Fortas took no part in the consideration or decision of this petition.

[fol. 89] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1965

No. 1302

MEMPHIS LIGHT, GAS AND WATER DIVISION, Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, ET AL.

ORDER ALLOWING CERTIORARI—June 13, 1966

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted. The case is consolidated with No. 1301 and a total of two hours is allotted for oral argument.

And it is further ordered that the duly certified copy of the transcript of the proceedings below, which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Fortas took no part in the consideration or decision of this petition.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1966—238-976/57